

CANFOR PULP INCOME FUND
CANFOR PULP LIMITED PARTNERSHIP

Consolidated Financial Statements

For the periods ended December 31, 2007 and 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) Terry Hodgins

Terry Hodgins
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 sheets of Canfor Pulp Income Fund (the "Fund") as at December 31, 2007 and December 31, 2006, and the consolidated statements of income, comprehensive income and accumulated earnings and distributions and cash flows for the year ended to December 31, 2007 and the six month period ended 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 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 Fund as at December 31, 2007 and December 31, 2006, and the results of its operations and its cash flows for the year ended December 31, 2007 and the six month period ended December 31, 2006 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC
February 19, 2008

Canfor Pulp Income Fund
Consolidated Statements of Income, Comprehensive Income and Accumulated Earnings and Distributions

(thousands of dollars, except unit and per unit amounts)	Year ended December 31, 2007	6 months ended December 31, 2006
Income		
Equity income in Canfor Pulp Limited Partnership	\$ 64,643	\$ 20,558
Net income before future income taxes	64,643	20,558
Future income taxes (note 8)	36,633	-
Net income	28,010	20,558
Distributions declared (note 5)	(65,308)	(30,419)
Earnings in excess of distributions – (deficit)	(37,298)	(9,861)
Weighted average number of Fund units	35,493,542	17,947,838
Net income per Fund unit, basic and diluted (in dollars)	\$ 0.79	\$ 1.15
Net income for the period	\$ 28,010	\$ 20,558
Other comprehensive income		
Equity interest in other comprehensive income of Canfor Pulp Limited Partnership	1,185	-
Comprehensive income	\$ 29,195	\$ 20,558
Accumulated Earnings and Distributions		
Balance, beginning of period – Accumulated earnings in excess of distributions – (deficit)	\$ (9,861)	\$ -
Accounting policy change (notes 3, 4)	2,363	-
Balance, beginning of period – Accumulated earnings in excess of distributions - (deficit), as restated	(7,498)	-
Earnings in excess of distributions - (deficit) - current period	(37,298)	(9,861)
Balance, end of period – Accumulated earnings in excess of distributions - (deficit)	\$ (44,796)	\$ (9,861)

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

Canfor Pulp Income Fund
Consolidated Statements of Cash Flows

(thousands of dollars)	Year ended December 31, 2007	6 months ended December 31, 2006
Cash generated from (used in)		
Operating activities		
Net income	\$ 28,010	\$ 20,558
Distributions received from Canfor Pulp Limited Partnership	73,827	17,641
Items not affecting cash:		
Equity income in Canfor Pulp Limited Partnership	(64,643)	(20,558)
Future income taxes (note 8)	36,633	-
	73,827	17,641
Financing activities		
Distributions paid to Unitholders	\$ (73,827)	\$ (17,641)
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 Sheets**

(thousands of dollars)	As at December 31, 2007	As at December 31, 2006
ASSETS		
Current Assets		
Distributions receivable from Canfor Pulp Limited Partnership (note 6)	\$ 4,259	\$ 12,778
Total current assets	4,259	12,778
Equity investment in Canfor Pulp Limited Partnership (note 4)	291,458	289,490
	\$ 295,717	\$ 302,268
LIABILITIES		
Current liabilities		
Distribution payable (note 5)	4,259	12,778
Total current liabilities	4,259	12,778
Future income taxes (notes 3, 8)	36,633	-
	40,892	12,778
UNITHOLDERS' EQUITY		
Unitholders' equity - 35,493,542 Fund units outstanding	299,351	299,351
Accumulated earnings and distributions	(44,796)	(9,861)
Accumulated other comprehensive income (note 7)	270	-
Total Unitholders' Equity	254,825	289,490
	\$ 295,717	\$ 302,268

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

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, 2007

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 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, B.C., 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 the comparative figures in the audited consolidated financial statements are for the six months ended December 31, 2006.

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. Significant areas requiring the use of management estimates are the valuation of the Fund's investment in the Partnership relative to its market value and the determination of future income tax.

Net Income per Fund Unit

Basic net income per Fund unit is based on the weighted average number of Fund units outstanding during the period. At December 31, 2007 and December 31, 2006 the Partnership had 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 as a result of such an exchange 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 only has current taxes on any taxable income not allocated to the Unitholders. For the periods ended December 31, 2007 and 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. Changes in Accounting Policies and New Pronouncements Not Yet Adopted

Future Income Taxes

In June 2007 legislation was substantively enacted to tax distributions of publicly traded income trusts, commencing in 2011. As a result, the Fund is now required to recognize the future income tax assets and liabilities expected to arise when the tax on distributions becomes applicable.

Future income tax assets and liabilities are determined based on the difference between the tax basis of the Fund's pro-rata ownership of the Partnership's assets and liabilities and the respective amounts reported in the financial statements. Future tax assets or liabilities are calculated using the substantively enacted tax rates for the periods in which the differences are expected to be settled. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

Financial Instruments

Effective January 1, 2007, the Fund adopted the Canadian Institute of Chartered Accountants' new Handbook Section 3855 "Financial Instruments – recognition and measurement" and Section 1530 "Comprehensive Income". These standards were adopted retroactively and comparative amounts of prior periods have not been restated.

Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the Consolidated Balance Sheets at fair value on initial recognition except for certain related party transactions. Subsequent measurement depends on the initial classification of the instrument. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the Consolidated Balance Sheets at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in income.

As a result of adopting these new standards, the Fund has classified its distribution receivable as loans and receivables. Distributions payable are classified as other liabilities and are measured at amortized cost.

Section 1530 introduces new requirements for situations when certain gains and losses ("other comprehensive income") must be temporarily presented outside of net income in a new Statement of Comprehensive Income. Comprehensive income is the change in the Fund's Unitholder's equity that result from transactions, events and circumstances from sources other than the Unitholders. For the period ended December 31, 2007, the Fund's other comprehensive income resulted from its equity interest in the Partnership (see note 3 to the consolidated financial statements of the Partnership).

New Accounting Pronouncements Not Yet Adopted

The CICA has issued two new standards which may affect the financial disclosures and results of operations of the Fund for interim and annual periods beginning January 1, 2008. The Fund will adopt the requirements commencing in the interim period ended March 31, 2008 and is considering the impact this will have on the Fund's financial statements.

1) Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Fund will be required to disclose the following, based on the information provided internally to the Fund's key management personnel:

- (i) qualitative information about its objectives, policies and processes for managing capital;

- (ii) summary quantitative data about what it manages as capital;
- (iii) whether during the period it complied with any externally imposed capital requirements to which it is subject;
- (iv) when the Fund has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

2) Section 3862 – Financial Instruments – Disclosures

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable 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. The Fund will be required to disclose the measurement basis or bases used, and the criteria used to determine classification for different types of instruments.

The Section requires specific disclosures to be made, including the criteria for:

- (i) designating financial assets and liabilities as held for trading;
- (ii) designating financial assets as available-for-sale; and
- (iii) determining when impairment is recorded against the related financial asset or when an allowance account is used.

4. Equity Investment in Canfor Pulp Limited Partnership

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

(thousands of dollars)	Year ended December 31, 2007	6 months ended December 31, 2006
Balance, beginning of period	289,490	116,560
Accounting policy change – Partners' equity of the Partnership	2,363	-
Accounting policy change – Accumulated other comprehensive income of the Partnership (note 7)	(915)	-
Issuance of Fund units for exchangeable Partnership units (November 30, 2006) – 21,239,537 Fund units	-	182,791
Equity in income of the Partnership	64,643	20,558
Equity interest in other comprehensive income of the Partnership	1,185	-
Distributions earned	(65,308)	(30,419)
Balance, end of period	291,458	289,490

The Fund's investment in the Partnership units is recorded using the equity method. Accounting policy changes above represent the Fund's share (49.8%) of the Partnership's adjustments to opening Partners' equity arising from the adoption of new accounting pronouncements and changes in accounting policies, all as described in notes to the consolidated financial statements of the Partnership.

5. Distributions

The Fund declared distributions during the 12 months of 2007 as follows:

(thousands of dollars, except per unit amounts)

Record Date	Payable Date	Amount per Fund Unit	Amount
		\$	\$
January 31, 2007	February 15, 2007	0.14	4,969
February 28, 2007	March 15, 2007	0.14	4,969
March 30, 2007	April 13, 2007	0.14	4,969
April 30, 2007	May 15, 2007	0.14	4,969
May 31, 2007	June 15, 2007	0.18	6,389
June 29, 2007	July 13, 2007	0.18	6,389
July 31, 2007	August 15, 2007	0.18	6,389
August 31, 2007	September 14, 2007	0.18	6,389
September 28, 2007	October 15, 2007	0.18	6,389
October 31, 2007	November 15, 2007	0.14	4,969
November 30, 2007	December 14, 2007	0.12	4,259
December 31, 2007	January 15, 2008	0.12	4,259
		1.84	65,308

The Fund's monthly distributions are based on the Partnership's monthly distributions.

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

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. Distributions earned from the Partnership for the year ended December 31, 2007 were \$65.3 million of which \$61.0 million was paid, with the balance of \$4.3 million receivable on December 31, 2007. For the six months ended December 31, 2006 distributions earned were \$30.4 million of which \$17.6 million was paid, with the balance of \$12.8 million receivable on December 31, 2006.

7. Accumulated Other Comprehensive Income

(thousands of dollars)	Year ended December 31, 2007
Balance, beginning of period – January 1, 2007	-
Accounting policy change - Accumulated other comprehensive loss of the Partnership	(915)
Balance, beginning of period – January 1, 2007 as restated	(915)
Other comprehensive income	1,185
Balance, end of period	270

8. Future Income Taxes

The following table reconciles the income tax expense calculated using statutory tax rates to the actual income tax expense.

(thousands of dollars)	Year ended December 31, 2007	6 months ended December 31, 2006
Expected income tax expense at statutory tax rate of nil (2006 – nil)	-	-
Future income taxes on temporary differences	36,633	-
	36,633	-

The temporary differences based on the Fund's 49.8% ownership of the Partnership are as follows:

(thousands of dollars)	December 31, 2007
Future income tax liability:	
Equity investment in the Partnership	46,747
Expected reversal of temporary differences prior to January 2011	(10,114)
	36,633

Based on a current estimate of the income tax liability at the beginning of 2011, the Fund has recorded a future income tax liability and corresponding non-cash future tax charge to net income. This non-cash charge relates to the Fund's 49.8% ownership in the Partnership and is based on temporary differences between the accounting and tax basis of the Partnership's assets and liabilities expected to reverse after January 1, 2011.

9. Financial Instruments

The Fund's financial instruments consist of distributions receivable from the Partnership and distributions payable to unitholders. The fair values of these financial instruments approximate their carrying values due to the relatively short period to maturity of these instruments.

10. Segmented Information

The Fund operates in one industry segment, namely investing in pulp and paper producing assets in one geographic region, Canada.

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, 2007 and December 31, 2006, and the consolidated statements of income, comprehensive 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, 2007 and December 31, 2006, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC
February 19, 2008

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

(millions of dollars)	Year ended December 31,	
	2007	2006 (note 1)
Sales	\$ 921.6	\$ 830.4
Costs and expenses		
Manufacturing and product costs	597.7	512.7
Freight and other distribution costs	111.0	114.1
Amortization	52.8	49.0
Selling and administration costs	25.8	23.4
	787.3	699.2
Operating income	134.3	131.2
Interest expense, net	(6.7)	(3.8)
Unrealized foreign exchange gain (loss) on long-term debt	19.5	(2.5)
Unrealized loss on derivative instruments (note 13)	(3.3)	-
Foreign exchange gain (loss) on working capital	(13.8)	3.9
Business acquisition costs	-	(5.9)
Other income (expense)	(0.2)	0.1
	(4.5)	(8.2)
Net Income	129.8	123.0
Other comprehensive income		
Adjustment for realized derivatives (note 16)	2.3	-
Comprehensive Income	\$ 132.1	\$ 123.0
Net income per Partnership unit (in dollars) (note 12)		
Basic and diluted	\$ 1.82	\$ 1.73
Weighted average Partnership units outstanding	71,270,025	71,270,025
Partners' Equity		
Balance, beginning of period	\$ 581.0	\$ 728.7
Accounting policy change (note 3)	2.9	-
Balance, beginning of period as restated	583.9	728.7
Net Income	129.8	123.0
Distributions to partners (note 15)	(131.1)	(88.5)
Other comprehensive income (note 16)	2.3	-
Net transactions with Canfor	-	(57.2)
Issuance of promissory note on acquisition	-	(125.0)
Balance, end of period	\$ 584.9	\$ 581.0

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

Canfor Pulp Limited Partnership
Consolidated Statements of Cash Flows

	Year ended December 31,	
(millions of dollars)	2007	2006 (note 1)
Cash and cash equivalents generated from (used in)		
Operating activities		
Net income	\$ 129.8	\$ 123.0
Items not affecting cash:		
Amortization	52.8	49.0
Unrealized foreign exchange loss (gain) on long-term debt	(19.5)	2.5
Unrealized loss on derivative instruments	3.3	-
Employee future benefits	5.2	7.5
Loss on disposal of fixed assets	1.1	-
Other	2.0	(3.3)
Cash flow from operations before working capital changes	174.7	178.7
Increase in non-cash working capital (note 14)	(25.0)	(10.5)
Cash flow from operating activities	149.7	168.2
Financing activities		
Distributions paid to partners	(148.3)	(62.7)
Payment of promissory note	-	(125.0)
Proceeds of long-term debt	-	125.7
Financing costs	-	(1.6)
Net transactions with Canfor	-	(57.2)
	(148.3)	(120.8)
Investing activities		
Property, plant and equipment, net (note 14)	(23.8)	(19.6)
Salary pension plan contribution (note 7)	(3.4)	-
	(27.2)	(19.6)
Increase (decrease) in cash and cash equivalents	(25.8)	27.8
Cash and cash equivalents, beginning of period	28.4	0.6
Cash and cash equivalents, end of period	\$ 2.6	\$ 28.4

Supplementary cash flow information (note 14)

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, 2007	As at December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	\$ 2.6	\$ 28.4
Accounts receivable (note 11)		
Trade	145.6	130.9
Other	9.9	6.7
Inventories (note 4)	136.8	111.0
Prepaid expenses	15.6	13.1
Total current assets	310.5	290.1
Property, plant and equipment (note 5)	585.6	598.6
Deferred charges and other assets (note 6)	12.9	5.0
	\$ 909.0	\$ 893.7
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 11)	\$ 156.9	\$ 125.5
Distributions payable (note 15)	8.6	25.8
Total current liabilities	165.5	151.3
Long-term debt (note 9)	108.7	128.2
Long-term liabilities (note 10)	49.9	33.2
	\$ 324.1	\$ 312.7
PARTNERS' EQUITY – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (note 1)	584.9	581.0
	\$ 909.0	\$ 893.7

Commitments and contingencies (notes 8, 17)

Subsequent event (note 19)

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, 2007 and 2006

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).

At December 31, 2007, Canfor owns 50.2% and Canfor Pulp Income Fund (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.

For all periods ending prior to July 1, 2006, these consolidated 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. For these periods, 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 were 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 "Net transactions with Canfor" in Partners' equity.

These consolidated 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.

Certain comparative figures have been reclassified to conform to current year presentation.

Economic Dependence

The Partnership depends on Canfor to provide approximately 66% (2006 – 64%) of its fibre supply as well as to provide certain key business and administrative services as described in note 11. As a result of these relationships 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, asset retirement obligations and environmental remediation.

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 pension, health care benefits and pension bridge plans to eligible retired employees. During the first quarter of 2007, the Partnership determined that with respect to its participation in the Canfor salaried pension plans it was able to determine the benefit obligations and the attributable assets related to its employees. As a result, the Partnership ceased to account for these pension costs on the basis of a multi-employer plan and adopted the pronouncements applicable to accounting for defined benefit pension plans. This change is presented on a retroactive basis, without restatement, as the relevant information is not available for prior periods. The Partnership's policy is included below and details are provided in note 7.

The Partnership accrues the costs and related obligations of the defined benefit salary pension plans, 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 and 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 10 years for the salary pension plan, 16 years for the pension bridge plan and 14 years for the other benefit plans. Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets. 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.

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 collectability is reasonably assured. Sales are reported net of discounts, allowances and vendor rebates. Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by 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.

Prior to January 1, 2007 the Partnership formally documented all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process included linking all derivatives to specific assets and liabilities or to specific firm commitments or forecasted transactions. The Partnership also formally assessed, both at the inception of the hedge and on an ongoing basis, whether the derivatives that were used in hedging transactions were effective in offsetting changes in fair values or cash flows of hedged items. Gains and losses on forward foreign exchange contracts which qualified as a hedge of US dollar denominated sales were recognized as an adjustment to revenue at the time that the contracts were settled. Gains and losses on natural gas swaps which qualified as a hedge were recognized as an adjustment to manufacturing costs when the contracts are settled.

Effective January 1, 2007 the Partnership adopted the Canadian Institute of Chartered Accountants' new Handbook Section 3865 "Hedges" (see Note 3).

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.

Major maintenance costs

The Partnership has 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 Partnership has presented the related unamortized expenditures in prepaid expense and deferred charges and other assets, as appropriate.

3. Changes in Accounting Policies and New Pronouncements Not Yet Adopted

The accounting policy changes impacting Partners' equity at January 1, 2007 are comprised of the following:

(millions of dollars)	
Defined benefit pension plans	6.3
Deferred financing costs	(1.6)
	4.7
Accumulated other comprehensive income (note 16)	(1.8)
	2.9

The aggregate adjustment resulting from the change in accounting policy and the adoption of new accounting pronouncements was an increase of \$2.9 million to opening Partners' equity.

Financial Instruments

Effective January 1, 2007, the Partnership adopted the Canadian Institute of Chartered Accountants' new Handbook Section 3855 "Financial Instruments – recognition and measurement", Section 3865 "Hedges" and Section 1530 "Comprehensive Income". These standards were adopted retroactively and comparative amounts of prior periods have not been restated.

Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the Consolidated Balance Sheet at fair value on initial recognition except for certain related party transactions. Subsequent measurement depends on the initial classification of the instrument. Loans and receivables and other financial liabilities are measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the Consolidated Balance Sheet at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in income.

As a result of adopting these new standards, the Partnership has classified its accounts receivable as loans and receivables. Bank indebtedness, accounts payable and accrued liabilities, and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost. Derivative instruments are recorded in the balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contract.

As a result of consideration of the new guidance provided in Section 3865 – "Hedges", on a prospective basis, the Partnership has determined not to utilize hedge accounting on its existing derivative instruments. As a result, these instruments, which were previously recorded using hedge accounting, were measured at fair value on January 1, 2007 with a corresponding adjustment through accumulated other comprehensive income (see note 16).

Section 1530 introduces new requirements for situations when certain gains and losses ("other comprehensive income") must be temporarily presented outside of net income in a new Statement of Comprehensive Income. Comprehensive income is the change in the Partner's equity that result from transactions, events and circumstances from sources other than the Partners.

In accordance with the transitional provisions, the Partnership has transferred the balance of deferred financing costs relating to the credit facilities and long-term debt entered into on November 30, 2006 to Partners' equity at January 1, 2007.

On a prospective basis the Partnership will expense all financing costs.

Asset Retirement Obligations

In accordance with the Canadian Institute of Chartered Accountants' Handbook Section 3110 "Asset Retirement Obligations", the Partnership recognizes the fair value of a liability for an asset retirement obligation in the period in

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

New Accounting Pronouncements Not Yet Adopted

The CICA has issued three new standards which may affect the financial disclosures and results of operations of the Partnership for interim and annual periods beginning January 1, 2008. The Partnership will adopt the requirements commencing in the interim period ended March 31, 2008 and is considering the impact this will have on the Partnership's financial statements.

1) Section 1535 – Capital Disclosures

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Partnership will be required to disclose the following, based on the information provided internally to the entity's key management personnel:

- (i) qualitative information about its objectives, policies and processes for managing capital;
- (ii) summary quantitative data about what it manages as capital;
- (iii) whether during the period it complied with any externally imposed capital requirements to which it is subject;
- (iv) when the Partnership has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

2) Section 3031 - Inventories

This Section prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

3) Section 3862 – Financial Instruments – Disclosures

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable 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. The Partnership will be required to disclose the measurement basis or bases used, and the criteria used to determine classification for different types of instruments.

The Section requires specific disclosures to be made, including the criteria for:

- (i) designating financial assets and liabilities as held for trading;
- (ii) designating financial assets as available-for-sale; and
- (iii) determining when impairment is recorded against the related financial asset or when an allowance account is used.

4. Inventories

(millions of dollars)	December 31, 2007	December 31, 2006
Pulp	63.7	48.9
Paper	14.0	11.6
Wood chips	10.7	5.4
Processing materials and supplies	48.4	45.1
	136.8	111.0

5. Property Plant and Equipment

(millions of dollars)	December 31, 2007		
	Cost	Accumulated amortization	Net
Land and improvements	14.5	-	14.5
Buildings, machinery and equipment	1,294.7	726.8	567.9
Construction in progress	3.2	-	3.2
	1,312.4	726.8	585.6

(millions of dollars)	December 31, 2006		
	Cost	Accumulated amortization	Net
Land and improvements	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

6. Deferred Charges and Other Assets

(millions of dollars)	December 31, 2007	December 31, 2006
Pension benefit plan (note 7)	11.3	-
Maintenance shutdown costs	1.4	3.0
Other	0.2	2.0
	12.9	5.0

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.

Total employee future benefit expenses were as follows:

(millions of dollars)	Year ended December 31	
	2007	2006
Pension plans	4.8	4.4
Other employee future benefit plans	6.1	6.4
Contributions to forest industry union plans	6.3	6.2
	17.2	17.0

Defined Benefit Plans

The measurement date for the accrued benefit obligations and the fair value of plan assets for accounting purposes is at September 30, 2007. The most recent actuarial valuation for funding purposes for the Canfor salaried employees pension plans in which the Partnership's employees participate was on December 31, 2006. The most recent actuarial valuations for the other post retirement benefit plan and the Pension Bridge Plan were on September 30, 2007 and September 30, 2005, respectively.

Information about the Partnership's defined benefit plans, including its identified participation in the Canfor salaried employees pension plans and other post-employment benefit plans and the Pension Bridge Plan, is as follows:

Defined Benefit Plan Assets

(millions of dollars)	2007		2006	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
			(Note 3)	
<i>Fair market value of plan assets</i>				
<i>Beginning of year</i>	\$ 46.4	\$ -	\$ -	\$ -
<i>Actual return on plan assets</i>	4.6	-	-	-
<i>Employer contributions</i>	7.8	0.7	-	0.6
<i>Employee contributions</i>	0.4	-	-	-
<i>Benefit payments</i>	(1.1)	(0.7)	-	(0.6)
<i>End of year</i>	\$ 58.1	\$ -	\$ -	\$ -

	Percentage of Plan Assets	
	2007	2006
<i>Plan assets consist of the following</i>		
<i>Equity securities</i>	63%	61 %
<i>Debt securities</i>	36%	34 %
<i>Real estate</i>	0%	2 %
<i>Other</i>	1%	3 %
	100%	100 %

Included in employer contributions in 2007 was a one time salary pension plan payment of \$3.4 million representing a payment above the normal funding requirements which was used to reduce the 2006 taxable income of the Partnership.

Defined Benefit Plan Obligations

(millions of dollars)	2007		2006	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
			(Note 3)	
<i>Accrued benefit obligation</i>				
<i>Beginning of year</i>	\$ 60.8	\$ 55.8	\$ 5.6	\$ 53.2
<i>Current service cost</i>	3.5	1.4	0.2	1.4
<i>Interest cost</i>	3.2	3.0	0.3	2.9
<i>Employee contributions</i>	0.4	-	-	-
<i>Benefit payments</i>	(1.1)	(0.7)	-	(0.6)
<i>Plan amendments</i>	-	-	1.4	-
<i>Actuarial loss (gain)</i>	(1.7)	(2.7)	3.0	(1.1)
<i>End of year</i>	\$ 65.1	\$ 56.8	\$ 10.5	\$ 55.8

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

(millions of dollars)	2007		2006	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
			(Note 3)	
<i>Fair market value of plan assets</i>	\$ 58.1	\$ -	\$ -	\$ -
<i>Accrued benefit obligation</i>	65.1	56.8	10.5	55.8
<i>Funded status of plans – (deficit)</i>	(7.0)	(56.8)	(10.5)	(55.8)
<i>Employer contributions after measurement date</i>	.9	0.2	-	0.2
<i>Unamortized transitional obligation (asset)</i>	(.8)	6.3	1.8	7.1
<i>Unamortized past service costs</i>	1.5	-	1.4	-
<i>Unamortized net actuarial loss</i>	12.4	14.7	4.3	18.3
<i>Accrued benefit asset (liability)</i>	\$ 7.0	\$ (35.6)	\$ (3.0)	\$ (30.2)

The accrued benefit asset (liability) is included in the Partnership's balance sheet as follows:

<i>Deferred charges (note 6)</i>	\$ 11.3	\$ -	\$ -	\$ -
<i>Accrued pension obligation (note 10)</i>	(4.3)	(35.6)	(3.0)	(30.2)
	\$ 7.0	\$ (35.6)	\$ (3.0)	\$ (30.2)

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

(millions of dollars)	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets	\$ 0.4	\$ -	\$ -	\$ -
Accrued benefit obligation	(11.6)	(35.6)	(3.0)	(30.2)
Funded status - plan deficit	\$ (11.2)	\$ (35.6)	\$ (3.0)	\$ (30.2)

Of the \$11.2 million of pension plan deficit noted above, \$9.9 million relates to the Pension Bridge Plan, which is an unfunded obligation of the employer under the terms of the collective agreement (2006 – \$9.6 million).

Other benefit plans are not funded, except to the extent that expenditures are incurred.

The expense for the Partnership sponsored defined benefit plans are as follows:

(millions of dollars)	2007			2006		
	Incurred in Year	Matching Adjustments ¹	Recognized in Year	Incurred in Year	Matching Adjustments ¹	Recognized in Year
Defined Benefit Pension Plans						
Current service cost, net of employee contributions	\$ 3.5	\$ -	\$ 3.5	\$ 0.2	\$ -	\$ 0.2
Interest cost	3.2	-	3.2	0.2	-	0.2
Return on plan assets	(4.5)	1.1	(3.4)	-	-	-
Actuarial loss (gain)	(1.7)	2.8	1.1	0.1	-	0.1
Plan amendments	-	0.1	0.1	-	-	-
Amortization of transitional obligation (asset)	-	(0.1)	(0.1)	0.2	-	0.2
	\$ 0.5	\$ 3.9	\$ 4.4	\$ 0.7	\$ -	\$ 0.7
Other Benefit Plans						
Current service cost, net of employee contributions	\$ 1.4	\$ -	\$ 1.4	\$ 1.4	\$ -	\$ 1.4
Interest cost	3.0	-	3.0	2.9	-	2.9
Actuarial loss (gain)	(2.7)	3.6	0.9	(2.2)	3.2	1.0
Amortization of transitional obligation (asset)	-	0.8	0.8	-	0.8	0.8
	\$ 1.7	\$ 4.4	\$ 6.1	\$ 2.1	\$ 4.0	\$ 6.1

¹ Accounting adjustments to allocate costs to different periods so as to recognize the long-term nature of employee future benefits

Significant assumptions

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

(weighted average assumptions)	2007		2006	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
<i>Accrued benefit obligation as of December 31:</i>				
<i>Discount rate</i>	5.60 %	5.50 %	5.25 %	5.25 %
<i>Rate of compensation increase</i>	3.0 %	n/a	3.0 %	n/a
<i>Benefit costs for year ended December 31:</i>				
<i>Discount rate</i>	5.25 %	5.25 %	5.25 %	5.25 %
<i>Expected long-term rate of return on plan assets</i>	7.0 %	n/a	7.0 %	n/a
<i>Rate of compensation increase</i>	3.0 %	n/a	3.5 %	n/a

Assumed health care cost trend rates

(weighted average assumptions)	2007	2006
Initial health care cost trend rate	5.83%	5.62%
Ultimate health care trend rate	4.35%	4.27%
Year ultimate rate is reached	2014	2011

Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the other benefit plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2007:

	1% Increase	1% Decrease
Accrued benefit obligation	\$ 11.6	\$ (9.1)
Total of service and interest cost	\$ 1.1	\$ (0.9)

8. Asset Retirement Obligations

(millions of dollars)	Year ended December 31, 2007
Balance beginning of period	-
Accrued obligation – ash pond	2.4
Accrued obligations - landfills	8.9
Accretion expense	0.1
Current expenditures	(0.3)
Changes in estimate	0.2
Balance end of period	11.3
Less current portion	(2.1)
Long term portion	9.2

During 2007, the Partnership recognized asset retirement obligations in respect of landfill closure costs. This reflects new information on all sites concerning the estimated timing of closure and closure alternatives. The obligations represent estimated future payments of \$20.1 million. Payments relating to landfill closure costs are expected to

occur at periods ranging from 10 to 25 years which have been discounted at 5.8% and 6.3% respectively. The current estimated fair value is \$9.2 million and the amount is included in long-term liabilities.

During 2007 an environmental containment liability was identified at the Intercon mill site arising from the normal operation of the ash pond. As a result, the Partnership recorded an obligation based on the fair value of the containment estimate of \$2.4 million, with a corresponding capital addition to the related asset. The ash pond was decommissioned and remediation work commenced in the fourth quarter. The current estimated fair value was reduced by \$0.3 million to \$2.1 million after current period spending on remediation.

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

9. Credit Facilities and Long-term Debt

The Partnership has a 3-year \$75 million syndicated unsecured revolving bank credit facility (the Revolving Facility) with \$27.4 million of the Revolving Facility reserved for a standby letter of credit issued to BC Hydro (note 17). 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, 2007 the Partnership was in compliance with all covenants.

At December 31, 2007 the Partnership had outstanding long-term debt of \$108.7 million (2006 - \$128.2 million) (US\$110.0 million) in the form of unsecured U.S. dollar private placement notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013.

The fair value of long-term debt at December 31, 2007 was \$114.2 million (US\$115.6 million).

10. Long-term Liabilities

(millions of dollars)	December 31, 2007	December 31, 2006
Accrued pension obligations (note 7)	4.3	3.0
Post employment benefits (note 7)	35.6	30.2
Derivative financial instruments	0.8	-
Asset retirement obligations (note 8)	9.2	-
	49.9	33.2

11. 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 \$136.5 million in 2007 (2006 - \$83.3 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 2007 were \$11.5 million (2006 - \$8.6 million). The Partnership purchased wood chips from Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, in the amount of \$0.7 million (2006 - nil). Purchased wood chips and hog fuel are included in manufacturing and product costs.

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 2007 was \$4.9 million (2006 - \$8.5 million), included in manufacturing and product costs and selling and administration costs. 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 2007 was \$1.6 million (2006 - \$1.5 million), included in manufacturing and product costs and selling and administration costs.

The Partnership markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill for which it earned commissions totaling \$2.1 million in 2007 (2006 - \$2.3 million), included in sales. The Partnership also purchased chemi-thermo mechanical pulp from the Canfor Taylor Pulp Mill for resale totaling \$7.1 million in 2007 (2006 - \$10.1 million). In respect of the products marketed and services provided for the Canfor Taylor Pulp Mill, the Partnership held balances of \$14.2 million in accounts receivable - trade (2006 - \$6.3 million) and \$15.7 million in accounts payable (2006 - \$6.6 million) to Canfor at December 31.

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 \$2.9 million in 2007 (2006 - \$4.7 million), included in sales. In respect of the products marketed and service provided for HSLP, the Partnership held balances of \$31.8 million in accounts receivable - trade (2006 - \$31.9) and \$35.0 million in accounts payable (2006 - \$23.1) to HSLP at December 31, 2007.

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 in 2007 was nil (2006 - \$3.7).

At December 31, 2007, a total of \$15.1 million (2006 - \$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, 2007 a total of \$0.3 million (2006 - \$0.8 million) was payable to Lakeland Mills Ltd. and Winton Global Lumber Ltd. for wood chips.

During 2007, the Partnership declared distributions totaling \$131.1 million to its limited partners. Distributions to Canfor were \$65.8 million, of which \$61.5 million was paid, with the balance of \$4.3 million payable on December 31, 2007. Distributions to the Fund were \$65.3 million, of which \$61.0 million was paid, with the balance of \$4.3 million payable on December 31, 2007. For the six months ended December 31, 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 \$30.4 million, of which \$17.6 million was paid, with the balance of \$12.8 million payable on December 31, 2006.

These transactions occurred in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. The accounts receivable and accounts payable balances are on similar terms and conditions as those accorded to unrelated parties.

12. 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.

13. Financial Instruments

The Partnership uses a variety of derivative instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, pulp prices and natural gas.

For the year ended December 31, 2007 the Partnership recorded realized losses of \$2.2 million on maturing commodity swaps hedging natural gas purchases as a charge to manufacturing and product costs. At December 31,

2007, the Partnership had outstanding commodity swaps hedging future natural gas purchases of 4.9 million gigajoules extending to October 2010. At December 31, 2007 the unrealized loss of \$2.7 million on these outstanding commodity swaps is recorded as a liability in accounts payable and accrued liabilities or long-term liabilities. For the year ended December 31, 2006, the Partnership had unrealized losses on outstanding natural gas swaps of \$0.8 million and pulp swaps of \$1.0 million. These instruments, which were previously recorded using hedge accounting, were measured at fair value on January 1, 2007 with a corresponding adjustment through other comprehensive income (see notes 3 and 16).

14. Supplementary Cash Flow Information

(millions of dollars)	Year ended December 31	
	2007	2006
Changes in non-cash working capital		
Accounts receivable	(18.1)	0.3
Inventories	(25.8)	(4.0)
Prepaid expenses	(2.5)	(8.2)
Accounts payable and accrued liabilities	21.4	1.4
	(25.0)	(10.5)
Capital expenditures		
Capital expenditures - cash	23.8	19.6
Capital expenditures – accruals	8.1	-
Asset retirement obligations – long term	9.1	-
	41.0	19.6
Net interest paid	6.8	2.5

15. Distributions

The Partnership declared distributions in the twelve months of 2007 as follows:

(millions of dollars, except per unit amounts)			
Record Date	Payable Date	Amount per Partnership Unit	Amount
		\$	\$
January 31, 2007	February 15, 2007	0.14	10.0
February 28, 2007	March 15, 2007	0.14	9.9
March 30, 2007	April 13, 2007	0.14	10.0
April 30, 2007	May 15, 2007	0.14	10.0
May 31, 2007	June 15, 2007	0.18	12.8
June 29, 2007	July 13, 2007	0.18	12.8
July 31, 2007	August 15, 2007	0.18	12.8
August 31, 2007	September 14, 2007	0.18	12.9
September 28, 2007	October 15, 2007	0.18	12.8
October 31, 2007	November 15, 2007	0.14	10.0
November 30, 2007	December 14, 2007	0.12	8.5
December 31, 2007	January 15, 2008	0.12	8.6
		1.84	131.1

16. Accumulated Other Comprehensive Income

(millions of dollars)	Year ended December 31, 2007
Balance, beginning of period	-
Accounting policy change for derivative instruments:	
Unrealized loss on natural gas swaps	(0.8)
Unrealized loss on pulp swaps	(1.0)
Balance, beginning of period, as restated	(1.8)
Adjustment for derivatives recorded in other comprehensive income	2.3
Balance, end of period	0.5

Since the inception of the Partnership, the total of the net income, accumulated other comprehensive income, less distributions is as follows:

(millions of dollars)	December 31, 2007
Cumulative net income	216.5
Cumulative distributions	(219.6)
Accumulated other comprehensive income	0.5
	(2.6)
Partners' capital – at July 1, 2006, as restated	587.5
Partner's equity, end of period	584.9

17. Commitments and Contingencies

The Partnership has committed to the following operating leases for property, plant and equipment. As at December 31, 2007, the future minimum lease payments under these operating leases were as follows:

(millions of dollars)	
2008	2.7
2009	1.5
2010	0.6
Thereafter	1.1
Total minimum lease payments	5.9

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 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, 2007, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount \$27.4 million is issued to BC Hydro.

18. Segmented Information ^(a)

(millions of dollars)	Pulp	Paper	Unallocated Costs ^(d)	Total
Year ended December 31, 2007				
Sales to external customers ^(b)	798.0	123.6	-	921.6
Sales of pulp to paper segment ^(c)	79.9	(79.9)	-	-
Operating income (loss)	152.6	(2.1)	(16.2)	134.3
Amortization	48.5	4.1	0.2	52.8
Capital expenditures	39.1	1.8	0.1	41.0
Identifiable assets	813.0	71.9	24.1	909.0
Year ended December 31, 2006				
Sales to external customers ^(b)	717.1	113.3	-	830.4
Sales to other segments ^(c)	71.4	(71.4)	-	-
Operating income (loss)	143.8	1.7	(14.3)	131.2
Amortization	45.0	3.8	0.2	49.0
Capital expenditures	17.0	0.8	1.8	19.6
Identifiable assets	784.1	70.8	38.8	893.7

- (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 the United States representing 44% (2006 – 41%).
- (b) Sales to the largest customer represented approximately 24% of pulp segment sales (2006 – two largest customers - 36%).
- (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 2007. For the first six months of 2006, head office administrative costs were based on allocated Canfor corporate expenses as described in Note 1.

19. Subsequent Event

On January 15, 2008 a fire at the Partnership's Prince George Pulp and Paper mill caused extensive damage to the chip screening and infeed system. Alternative chip screening and infeed systems are being investigated to minimize pulp production disruptions at this mill. The Partnership has property damage and business interruption insurance to limit the financial loss to the Partnership. The occurrence is not expected to have a material effect on the financial condition of the Partnership.