

CANFOR PULP INCOME FUND

CANFOR PULP LIMITED PARTNERSHIP

Management's Discussion and Analysis

For the year ended December 31, 2007

Canfor Pulp Income Fund and Canfor Pulp Limited Partnership 2007 Report to Unitholders Management's Discussion and Analysis

Canfor Pulp Income Fund (the Fund) earns income from its 49.8% indirect interest in Canfor Pulp Limited Partnership (the Partnership). The Fund accounts for its investment in the Partnership on the equity basis and does not consolidate the operations of the Partnership. In order for the Fund's unitholders to understand the results of operations, the audited consolidated financial statements with accompanying notes are presented for both the Fund and the Partnership. The Partnership did not have an operating business prior to July 1, 2006, and the comparative results prior to this date represent the northern bleached softwood kraft (NBSK) business of Canadian Forest Products Ltd., a subsidiary of Canfor Corporation (collectively Canfor), which the Partnership acquired on July 1, 2006. This Management's Discussion and Analysis (MD&A) provides a review of the significant developments that have impacted the Partnership's and the Fund's performance for the year ended December 31, 2007 relative to the prior year. This MD&A should be read in conjunction with the audited consolidated financial statements and accompanying notes for the Fund and the Partnership. Additional information relating to the Fund and the Partnership, including the Fund's Annual Information Form (AIF) dated March 19, 2007, is available on SEDAR at www.sedar.com or at www.canforpulp.com.

In this document, references are made to EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization and before other non-operating income and expenses) and adjusted distributable cash. The Partnership considers EBITDA to be an important indicator for identifying trends in the Partnership's performance and of the Partnership's ability to generate funds to meet its debt service, capital expenditure requirements and to make cash distributions to its partners. Adjusted distributable cash is a measure of cash flow used by management to determine the level of cash distributions. EBITDA and adjusted distributable cash should not be considered as alternatives to net income or cash flow from operations as determined in accordance with Canadian generally accepted accounting principles. As there is no standardized method of calculating these measures, the Partnership's use of these terms may not be directly comparable with similarly titled measures used by other companies or income funds.

Calculations of EBITDA and adjusted distributable cash are provided in a schedule at the end of this MD&A.

In this MD&A, for the 2006 year and all periods ending prior to July 1, 2006, the financial information presented for the Partnership represents its business on a carve out basis (continuity of interests) from Canfor, as if operated as a stand-alone partnership entity for the full periods. The financial information presented includes allocations of certain of Canfor's assets, liabilities and costs. The financial condition, results of operations and cash flows for these periods are not necessarily indicative of the financial condition, results of operations or cash flows that would have been incurred if the business was a separate legal entity.

The information in this report is as at February 19, 2008.

Forward-Looking Statements

Certain statements in this MD&A constitute "forward-looking statements" which involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results, performance or achievements expressed or implied by such statements. Words such as "expects", "anticipates", "intends", "plans", "will", "believes", "seeks", "estimates", "should", "may", "could" and variations of such words and similar expressions are intended to identify such forward-looking statements. The risks and uncertainties are detailed from time to time in reports filed by the Fund with the securities regulatory authorities in all of the provinces and territories of Canada to which recipients of this MD&A are referred to for additional information concerning the Fund and Partnership, its prospects and uncertainties relating to the Fund and Partnership and its prospects. These statements are based on management's current expectations and beliefs and actual events or results may differ materially. New risk factors may arise from time to time and it is not possible for management to predict all of those risk factors or the extent to which any factor or combination of factors may cause actual results, performance and achievements of the Fund and Partnership to be materially different from those contained in forward-looking statements. The forward-looking statements are based on current information and expectations and the Fund and Partnership assume no obligation to update such information to reflect later events or developments, except as required by law.

Forward-looking statements in this MD&A include statements made under:

- "Outlook – Pulp" on page 11;
- "Outlook – Kraft Paper Markets" on page 12;
- "Changes in Financial Position" on page 14, the first paragraph under that heading;
- "Subsequent Event" on page 17; and
- "Standardized Distributable Cash and Cash Distributions" on page 24.

Material risk factors that could cause actual results to differ materially from the forward-looking statements contained in this MD&A include: general economic, market and business conditions; product selling prices; raw material and operating costs; exchange rates; changes in law and public policy; and opportunities available to or pursued by the Fund and Partnership. Additional information concerning these and other factors can be found in this MD&A under the headings “Risks and Uncertainties Relating to the Structure of the Fund” and “Risks and Uncertainties Related to the Business and the Industry”.

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, BC, Canada. The Fund has been established to acquire and hold, through a wholly owned trust, the Canfor Pulp Trust (the Trust), investments in Limited Partnership Units of 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 limited partner holds an ownership interest in the General Partner equal to its proportionate interest in the Partnership.

At February 19, 2008, 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 and Canfor holds 35,776,483 Class B Exchangeable Limited Partnership Units, representing 50.2% of the Partnership.

Each unitholder participates pro-rata in any distributions from the Fund. Under present income tax legislation, income tax obligations related to the distributions of the Fund are the obligations of the unitholders and the Fund is only taxable on any amount not allocated to the unitholders.

2007 HIGHLIGHTS

- Distributions totaled \$65.3 million or \$1.84 per Fund unit in 2007.
- Net income before future income taxes of \$64.6 million as compared to \$20.5 million for the six months ended December 31, 2006.
- Future income tax non-cash charge to income of \$36.6 million as a result of legislation substantively enacted to tax distributions of publicly traded income trusts, commencing in 2011.

EQUITY INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

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

(thousands of dollars)	Year 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	(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. 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.

SELECTED ANNUAL FUND FINANCIAL INFORMATION

(thousands of dollars, except per unit amounts)	Year 2007	Six months ended December 31, 2006
Equity income in Canfor Pulp Limited Partnership	64,643	20,558
Net income ¹	28,010	20,558
Net income per Fund unit	\$0.79	\$1.15
Distributions earned from the Partnership	65,308	30,419
Distributions declared to unitholders	65,308	30,419
Distributions declared per unit	\$1.84	\$1.24

Note: ¹ In 2007 the Fund recorded a non-cash future income tax charge of \$36.6 million to net income relating to the Fund's 49.8% ownership in the Partnership and based on temporary differences between the accounting and tax basis of the Partnership's assets and liabilities expected to reverse after January 1, 2011.

2007 COMPARED TO 2006

For the year ended December 31, 2007, the Fund had net income of \$28.0 million, or \$0.79 per unit compared to net income of \$20.6 million, or \$1.15 per Fund unit for the six months ended December 31, 2006. These results represent the Fund's share of the Partnership's earnings for the period. Distributions declared by the Partnership and accruing to the Fund were \$65.3 million, or \$1.84 per Fund unit of which \$4.3 million was receivable at December 31, 2007 as compared to \$30.4 million, or \$1.24 per Fund unit of which \$12.8 million was receivable at December 31, 2006. Cash distributions received from the Partnership are the only source of liquidity for the Fund. The Fund's requirements for administrative services are minimal and are funded and expensed by the Partnership.

SELECTED QUARTERLY FUND FINANCIAL INFORMATION

(thousands of dollars, except per unit amounts, unaudited)	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006
Equity income in Canfor Pulp Limited Partnership	5,999	16,541	17,900	24,203	12,184	8,374
Net income (loss) ¹	8,703	16,541	(21,437)	24,203	12,184	8,374
Net income (loss) per Fund unit	\$0.25	\$0.46	(\$0.60)	\$0.68	\$0.56	\$0.59
Distributions earned from the Partnership	13,487	19,167	17,747	14,907	24,147	6,272
Distributions declared to unitholders	13,487	19,167	17,747	14,907	24,147	6,272
Distributions declared per Fund unit	\$0.38	\$0.54	\$0.50	\$0.42	\$0.80	\$0.44

Note: ¹ In the second quarter of 2007 the Fund recorded a non-cash future income tax charge of \$39.3 million to net income relating to the Fund's 49.8% ownership in the Partnership and based on temporary differences between the accounting and tax basis of the Partnership's assets and liabilities expected to reverse after January 1, 2011. A recovery reduced this liability in the fourth quarter by \$2.7 million based on updated estimates of the temporary differences.

FOURTH QUARTER 2007 RESULTS

For the quarter ended December 31, 2007, the Fund had net income of \$8.7 million, or \$0.25 per Fund unit, representing its share of the Partnership's earnings for the period. Distributions declared by the Partnership and accruing to the Fund were \$13.5 million of which \$4.3 million was receivable at December 31, 2007. Cash distributions received from the Partnership are the only source of liquidity for the Fund. The Fund's requirements for administrative services are minimal and are funded and expensed by the Partnership.

FUND DISTRIBUTIONS

The Fund is entirely dependent on distributions from the Partnership to make its own distributions and declares distributions on a monthly basis with the record date on the last business day of each month and payable within the 15 days following. Distributions from the Fund's investment in the units of the Partnership and distributions payable by the Fund to its unitholders are recorded when declared. During the fourth quarter of 2007, the Fund declared distributions of \$0.38 per Fund unit or a total of \$13.5 million.

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, primarily due to differences between capital expenditure amounts and amortization and other non-cash expenses of the Partnership.

FUND UNITS

At February 19, 2008, the Fund had 35,493,542 units outstanding.

RISKS AND UNCERTAINTIES RELATED TO THE STRUCTURE OF THE FUND

Control of the Partnership

Pursuant to a shareholders' agreement, Canfor is entitled to appoint four of the seven directors to the board of the General Partner for so long as it owns not less than 30% of the outstanding Limited Partnership Units. For so long as Canfor holds not less than a 20% indirect economic interest in the Partnership, Canfor's consent will be required in order to approve certain significant transactions of the Partnership. In addition, under the Exchange Agreement, the Fund and the Trust will agree not to take certain actions without the prior approval of Canfor. As a result of these rights, Canfor will exercise significant influence or control over transactions submitted to the board of the General Partner and to the Fund trustees. Canfor may have sufficient voting power to prevent a change of control of the Partnership. The Fund has an indirect interest in the Partnership and has influence, but not control over the transactions of the Partnership.

The interests of Canfor may conflict with those of Fund unitholders.

Dependence on the Partnership

The Fund is entirely dependent on the operations and assets of the Partnership. Cash distributions to unitholders will be dependent on, among other things, the ability of the Partnership to make cash distributions. The ability of the Fund and its subsidiaries to make cash distributions or other payments or advances is subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities.

Cash Distributions Are Not Guaranteed and Will Fluctuate with the Business Performance

Although the Fund intends to distribute the cash distributions received through the Canfor Pulp Trust from the Partnership, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Fund units, there can be no assurance regarding the amount of income to be generated by the Partnership's business or ultimately the cash distributed to the Fund. The ability of the Fund to make cash distributions, and the actual amount distributed, will be entirely dependent on the operations and assets of the Partnership, and will be subject to various factors including its financial performance, its obligations under applicable credit facilities, fluctuations in its working capital, the sustainability of its margin and its capital expenditure requirements. The market value of the Fund units may deteriorate if the Fund is unable to meet its distribution targets in the future.

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.

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.

CRITICAL ACCOUNTING 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 recorded in the financial statements. Management regularly reviews these estimates and assumptions based on currently available information. The determination of the future income tax liability requires management to estimate the future impacts of amortization of capital assets, capital cost allowance claims for tax purposes and changes to actuarial estimates of employee benefit plans. Changes in these estimates could have a material impact on the calculation of the liability.

CHANGE IN ACCOUNTING POLICIES

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 Fund 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.

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.

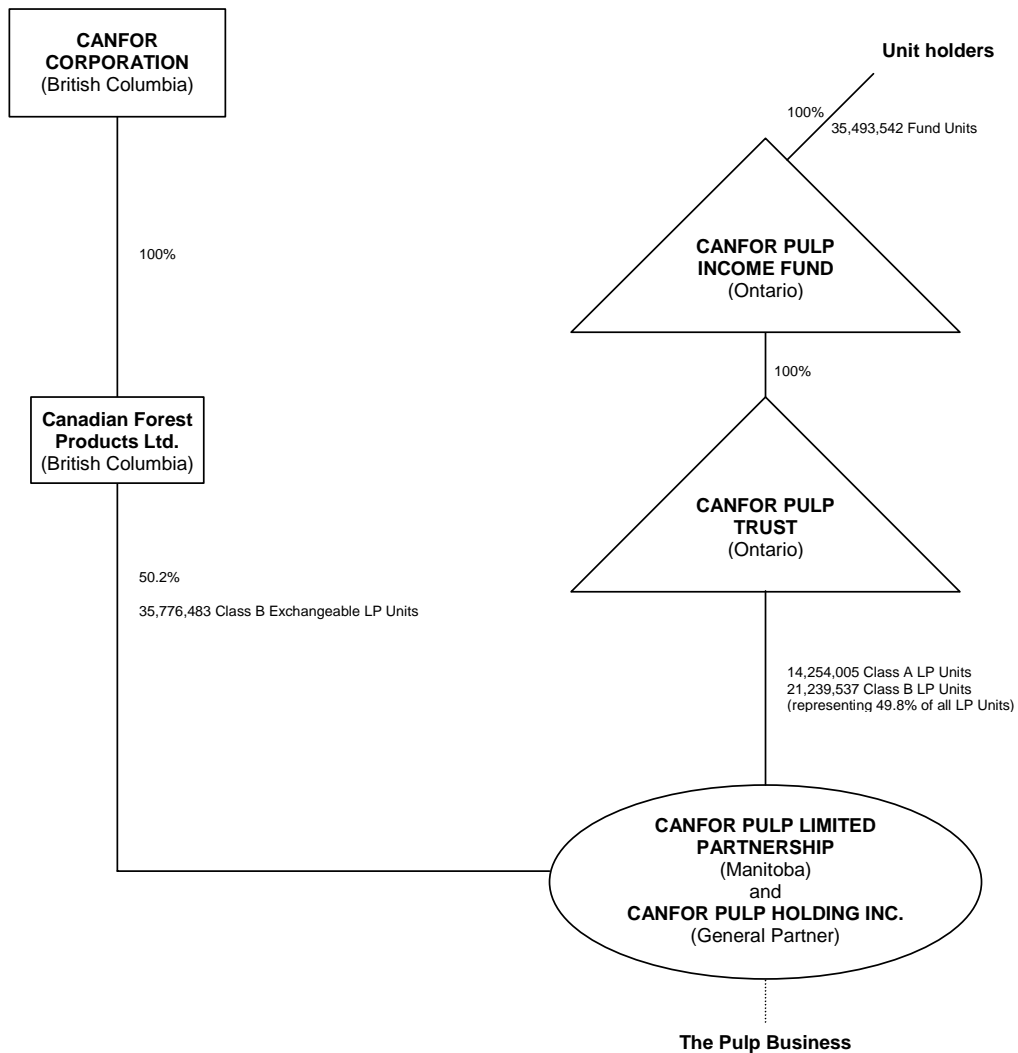
CANFOR PULP LIMITED PARTNERSHIP

Structure

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 Canfor. The business consists of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, BC and a marketing group based in Vancouver, BC (the Pulp Business).

At February 19, 2008, the Fund indirectly holds a total of 14,254,005 Class A Limited Partnership Units and 21,239,537 Class B Limited Partnership Units, representing 49.8% of the Partnership and Canfor owns the remaining 50.2%. The Partnership is managed, on behalf of the limited partners, by Canfor Pulp Holding Inc., the General Partner. Below is a simplified schematic of the ownership structure.

Partnership Structure



Business

The Partnership is a leading global supplier of pulp and paper products with operations based in the central interior of British Columbia. The Partnership's strategy is to maximize cash flows and enhance the value of its assets by: (i) preserving its low-cost operating position, (ii) maintaining the premium quality of its products and (iii) opportunistically acquiring high quality assets.

The Partnership owns and operates three mills with annual capacity to produce over one million tonnes of northern softwood market kraft pulp, 90% of which is bleached to become NBSK pulp for sale to the market, and approximately 140,000 tonnes of kraft paper.

2007 HIGHLIGHTS

- Distributions to partners totaled \$131.1 million or \$1.84 per Partnership unit.
- EBITDA of \$188.5 million, an increase of \$8.3 million compared to 2006.
- 2007 sales increased \$91.2 million to \$921.6 million from \$830.4 million in 2006.
- Annual record of 1,175,900 for total tonnes produced exceeding the previous record set in 2006 by 31,400 tonnes.
- Best year ever for safety.

Selected Annual Information

(millions of dollars except volumes and per unit amounts, unaudited)

	2007	2006	2005
Sales volume - major products			
Pulp - thousands of metric tonnes	1,023.6	1,001.5	982.1
Paper - thousands of metric tonnes	129.5	124.6	127.2
Sales by segment²			
Pulp	798.0	717.1	653.8
Paper	123.6	113.3	117.4
Total sales	921.6	830.4	771.2
Operating income (loss)²			
Pulp	152.6	143.8	27.3
Paper	(2.1)	1.7	3.0
Unallocated costs	(16.2)	(14.3)	(13.6)
Total operating income	134.3	131.2	16.7
Non-operating income (expense)²			
Interest expense, net	(6.7)	(3.8)	-
Foreign exchange gain (loss) on long-term debt	19.5	(2.5)	-
Unrealized loss on derivative instruments	(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	(0.2)
Total non-operating expense	(4.5)	(8.2)	(0.2)
Net income	129.8	123.0	16.5
Total assets²	909.0	893.7	878.4
Total long-term debt	108.7	128.2	-
Net income per Partnership unit			
Basic and diluted	1.82	1.73	0.23
Distributions declared	131.1	88.5	-
Average exchange rate (US\$/Cdn\$)¹	0.930	0.882	0.825

Notes: ¹ Source – Bank of Canada (average noon rate for the period)

² Comparative figures have been reclassified to conform to current year presentation.

2007 Compared To 2006

The 2007 year was highlighted with another record year for operational performance and safety, strong markets and a good cost structure. Net income for 2007 increased by \$6.8 million and EBITDA by \$8.3 million over 2006. The impact of the stronger Canadian dollar and substantially higher fibre costs were more than offset by increased NBSK list prices and higher production and sales volumes for pulp and paper. Pulp realized prices in Canadian dollar terms improved by 9% when compared to the prior year as a 14% improvement in NBSK list price was partially offset by the stronger Canadian dollar. The Bank of Canada noon rate averaged US\$0.930 in 2007 compared to US\$0.882 in 2006 translating into a negative \$39 million impact to EBITDA. Sales volumes for NBSK market pulp and kraft papers increased by 22,100 and 4,900 tonnes respectively when compared to the prior year. Fibre costs increased by 44% when compared to 2006 and were directly related to higher prices for sawmill residual chips and an increase in higher cost whole log chip volume. The increase in sawmill residual chip prices was due to higher pulp mill sales returns and market conditions brought about by reductions in sawmill residual chip volumes. The reduction in sawmill residual chip volumes precipitated the need to source higher cost whole log chips in 2007. Exclusive of fibre costs, 2007 unit cash manufacturing costs were maintained at 2006 levels.

OPERATING RESULTS BY BUSINESS SEGMENT

Pulp

(millions of dollars unless otherwise noted, unaudited)	2007	2006
Sales ¹	\$ 798.0	\$ 717.1
EBITDA ¹	\$ 202.5	\$ 188.8
EBITDA margin ¹	25%	26%
Operating income ¹	\$ 152.6	\$ 143.8
Average pulp list price – (US\$ per tonne, delivered to U.S.A.)	\$ 823	\$ 721
Average pulp list price (Cdn\$ per tonne, delivered to U.S.A.)	\$ 885	\$ 817
Production – pulp (000 mt)	1,044.3	1,015.4
Shipments – Partnership-produced pulp (000 mt)	1,023.6	1,001.5
<i>Marketed on behalf of HSLP & Canfor (000 mt)</i>	571.9	570.6

Note: ¹ Comparative figures have been reclassified to conform to current year presentation.

The 2007 operating income improved by \$8.8 million, when compared to the previous year. The impact of the stronger Canadian dollar and substantially higher fibre costs were more than offset by increased NBSK list prices and higher production and sales volumes for pulp. Pulp realized prices in Canadian dollar terms improved by 9% when compared to the prior year as a 14% improvement in NBSK list price was partially offset by the stronger Canadian dollar. The impact of the stronger Canadian dollar was approximately \$33 million when compared to the same period last year. Shipments of NBSK market pulp increased by 22,100 tonnes when compared to the prior year. Fibre costs increased by 44% when compared to 2006, directly related to higher prices for sawmill residual chips and an increase in higher cost whole log chip volume.

Operations

In 2007 the mills produced a record level of tonnes surpassing the previous record set in 2006 by 31,400 tonnes. The back to back production records for total tonnes in 2006 and 2007 represent an increase of 51,400 tonnes when compared to the prior record set in 2004. Individual mill production records were achieved at the Northwood mill, 589,000 tonnes in 2007 versus 562,000 in 2006 and Prince George pulp and paper mill, 280,000 tonnes in 2007 versus the prior record of 279,000 set in 2000. A total of 30 days of scheduled maintenance downtime was taken at the pulp mill facilities, the same number of days as the prior year.

Markets

Market conditions during 2007 remained strong. The Pulp and Paper Products Council (PPPC), reported market pulp inventories (World 19 Producers) ended December at 29 days of supply for all grades. Softwood kraft market pulp inventories were at 27 days of supply, one day above where softwood inventories stood at the end of the prior quarter. Generally 30 days of supply of inventory is considered representative of a balanced market. Market pulp shipments for the year were up 3.4% for all grades, but only up 0.9% for softwood pulp. While the shipment levels were healthy, production since the end of the third quarter has outpaced demand, leading to the one-day increase in producer inventories.

The printing and writing paper sector, which is the largest customer sector for the Partnership, has seen flat to slightly lower demand this year versus the same period of 2006. PPPC statistics covering the majority of our markets indicate demand was down 0.6% for the year. However by grade, coated mechanical paper demand, a large consumer of the Partnership's products, was up by 2.5% for the year. Most of the demand reduction was in coated and uncoated woodfree papers, not a target market for the Partnership.

There is still significant supply uncertainty for buyers of northern softwood kraft market pulp. This is primarily due to the impact on Canadian and European producers of the cost and availability of fibre and the weakness of the US dollar. Canadian pulp mills that are reliant on residual woodchips from sawmills are facing supply issues due to the large amount of downtime in the sawmilling sector. In Europe producers also face fibre shortages and competition with biomass energy producers for wood chips.

The announced price for January 2008 for both the USA and Northwest Europe is US\$880 per tonne. This is up US\$30 for the USA and US\$50 for Europe since the beginning of the fourth quarter. By comparison, the fourth quarter of 2006 started and ended with prices at US\$770 per tonne in the USA and US\$730 per tonne in Europe.

Outlook – Pulp

The Partnership's production levels for 2008 are expected to be similar to 2007, with the exception of the reduction related to the fire at the Prince George Pulp and Paper mill (see "Subsequent Event" on page 17). Higher daily operating rates are expected to be offset by slightly longer planned maintenance and capital outages. Both Northwood and Intercontinental mills will extend shutdowns; at Northwood to perform maintenance and modest capital improvements on its digester and recovery boilers and at Intercon to perform similar improvements on its digester and pulp machine. These improvements, which are primarily debottlenecking, will allow production growth to resume in 2009.

The demand and the price for market pulp are expected to remain strong through the first half of 2008. The seasonal decline in demand in the December to February period is typically followed by a surge in demand in the spring. The US election and the summer Olympics in China are expected to bolster demand for pulp throughout much of 2008. Furthermore, the supply of market pulp is curtailed each spring as mills in the northern hemisphere shutdown for annual maintenance. Combined, these market dynamics are expected to keep the pulp market balanced and allow for flat or slightly higher prices over the first half of the year.

Paper

(millions of dollars unless otherwise noted, unaudited)	2007	2006
Sales ¹	\$ 123.6	\$ 113.3
EBITDA ¹	\$ 2.0	\$ 5.5
EBITDA margin ¹	2%	5%
Operating (loss) income ¹	\$ (2.1)	\$ 1.7
Production – paper (000 mt)	131.6	129.1
Shipments – paper (000 mt)	129.5	124.6

Note: ¹ Comparative figures have been reclassified to conform to current year presentation.

The 2007 operating results were \$3.8 million unfavourable when compared to 2006. The impact of the stronger Canadian dollar and higher costs for slush pulp, which is transferred to the paper mill at market price, were offset by improved paper prices, higher sales volumes and overall improved productivity. Net realized prices in US dollars increased by 11% over the prior year. However, the impacts of the stronger Canadian dollar resulted in only a 5% increase in net realized prices in Canadian terms. Also unfavourably impacting results were the higher costs for slush pulp which increased by 10% over 2006. Partially offsetting this were increased sales volumes of 4,900 tonnes when compared to 2006.

Operations

2007 included the lowest year for medical incidents and operational performance records for average tonnes per day and average tonnes per day to customer orders. Tonnes per day averaged 375 in 2007 slightly exceeding the previous record set in 2004. A key performance indicator for the paper machine is tonnes produced to customer orders which set an annual best in 2007 averaging 361 tonnes per day compared to the previous record set in 2006 of 352. Overall, paper production for the 2007 year improved by 2,500 tonnes when compared to 2006. Operations continue to focus on higher margin bleached paper production, which averaged 71% in 2007 compared to 70% in 2006.

Markets

Global demand for sack kraft paper remained strong through the end of the year with continued upward price movement. Offshore markets showed continued strength in 2007. The U.S. market has been impacted by the slowdown in U.S. housing starts with sack paper demand off by 6%¹ during 2007. Offsetting the decrease in sack kraft paper demand was reduced supply of paper imports from Europe as a result of eroding margins due to increased freight rates and the strengthening of the Euro relative to the U.S. dollar.

Note ¹: Paper Shipping Sack Manufacturers' Association statistics.

Outlook – Kraft Paper Markets

Heading into 2008, price increases in the export and to a lesser extent the North American markets are expected. A US\$50 per tonne increase is expected to be fully implemented by the end of the first quarter. Continued supply and demand balance for both white and brown grades leads to a favourable outlook for 2008.

Non-Segmented Costs

<i>(millions of dollars)</i>	2007	2006
Unallocated costs	\$ 16.2	\$ 14.3
Interest expense, net	6.7	3.8
Unrealized loss on derivative instruments	3.3	-
Unrealized foreign exchange (gain) loss on long-term debt	(19.5)	2.5
Foreign exchange (gain) loss on working capital ¹	13.8	(3.9)
Business acquisition costs	-	5.9
Other expense (income)	0.2	(0.1)
	\$ 20.7	\$ 22.5

Note: ¹ Comparative figures have been reclassified to conform to current year presentation.

Unallocated Costs

Total unallocated costs for 2007 of \$16.2 million were \$1.9 million higher than the prior year. The increase over the prior year is mainly attributable to the higher performance based incentive plan expense.

Interest Expense

Net interest expense during 2007 was primarily the result of interest on long-term debt offset by interest income on cash and cash equivalent balances. No interest expense is shown for periods prior to July 2006, when the pulp business was an operating segment of Canfor and interest expense was not allocated.

Other Non-segmented Items

The unrealized gains and losses on derivative instruments result from the adoption of the Canadian Institute of Chartered Accountants (CICA) new Handbook Section 3855 "Financial Instruments" at January 1, 2007 and the Partnership's decision to discontinue its policy of hedge accounting. The net unrealized loss of \$3.3 million recorded in the year relates to a revaluation to market of outstanding natural gas swaps at the end of the year. The natural gas swaps are used to fix the price on a portion of the Partnership's ongoing natural gas requirements.

The unrealized foreign exchange gain on long-term debt and the foreign exchange loss on working capital are the direct result of translating U.S. dollar balances at period-end exchange rates and reflect the effect of the stronger Canadian dollar.

SELECTED QUARTERLY PARTNERSHIP FINANCIAL INFORMATION

(unaudited)	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Sales and Income (millions of dollars)								
Sales ¹	215.1	228.9	239.4	238.2	225.2	213.6	196.1	195.5
Operating income ¹	11.7	35.4	39.2	48.0	45.6	49.0	16.9	19.7
EBITDA ¹	27.9	48.8	51.7	60.1	58.2	61.8	28.0	32.2
Net income	12.1	33.2	35.9	48.6	44.8	41.9	15.9	20.4
Per Partnership unit (dollars) ²								
Net income basic and diluted	0.17	0.46	0.51	0.68	0.63	0.59	0.22	0.29
Statistics								
Pulp shipments (000 mt)	253.6	257.1	259.8	253.1	249.8	251.4	244.6	255.7
Paper shipments (000 mt)	32.4	30.8	35.9	30.4	32.7	29.5	31.3	31.1
Average exchange rate (US\$/Cdn\$) ³								
	1.019	0.957	0.911	0.854	0.878	0.892	0.891	0.866
Average pulp list price – (US\$ per tonne, delivered to U.S.A.)								
	857	837	810	790	770	757	705	653

Notes: ¹ Comparative figures have been reclassified to conform to current year presentation.

² Based on Partnership units outstanding at December 31, 2007 (71,270,025) for all periods.

³ Source – Bank of Canada (average noon rate for the period).

Sales are primarily influenced by changes in market pulp prices, sales volumes and fluctuations in Canadian dollar exchange rates. Operating income, net income and EBITDA are primarily impacted by the level of sales and price fluctuations in raw material inputs, energy prices, maintenance costs and the timing of scheduled maintenance downtime. Net income is also impacted by fluctuations in the Canadian dollar, due to the revaluation to the period end rate of U.S. denominated working capital balances and the U.S. denominated long-term debt. The third quarter of 2006 also included a charge for transaction costs of \$5.9 million related to the spinout of Canfor's pulp business into the Partnership.

SUMMARY OF FINANCIAL POSITION

The following table summarizes the Partnership's financial position as at the end of the following periods:

(millions of dollars, except for ratios, unaudited)	Year 2007	Year 2006
Ratio of current assets to current liabilities	1.88	1.92
Ratio of net debt to partners' equity ¹	0.18	0.17
Increase (decrease) in cash and cash equivalents	\$ (25.8)	\$ 27.8
Comprised of cash flow from (used in):		
Operating activities	\$ 149.7	\$ 168.2
Financing activities	\$ (148.3)	\$ (120.8)
Investing activities	\$ (27.2)	\$ (19.6)

Note: ¹ Net debt consists of long-term debt net of cash and cash equivalents.

Changes in Financial Position

For the year, operating activities generated \$149.7 million in cash compared to \$168.2 million in 2006. The year over year reduction in cash generated is mainly attributable to an increase in working capital in 2007, primarily as a result of higher inventories. The increase in inventories is due to increases in both volume and unit costs of finished pulp and chips. During 2007, the Partnership extended whole log chipping initiatives to mitigate the impact of sawmill curtailments on the supply of sawmill residual chips and to rebuild chip inventories to target levels. The reduced sawmill residual chips depleted chip inventory levels at the end of 2006 and restricted supply throughout 2007. Finished pulp inventories increased in the fourth quarter due to specific customer curtailments. Planned pulp maintenance production curtailments in the first half of 2008 are expected to reduce these inventories to normal levels. Also contributing to the higher finished pulp and chip inventory values at the end of 2007 as compared to 2006, was the higher cost whole log chipping component in ending inventory.

The cash used in financing activities of \$148.3 million in the year represents distributions paid to the limited partners, Canfor and the Fund. Cash flows from financing activities in the prior year also include net cash transactions with Canfor prior to the spinout on July 1, 2006.

The cash used in investing activities is comprised of \$23.8 million relating to capital expenditures net of accruals and non-cash increases in asset retirement obligations and 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.

LIQUIDITY AND FINANCIAL REQUIREMENTS

At the end of the current year, the Partnership had cash and cash equivalents totalling \$2.6 million. Cash and cash equivalents includes cash on hand and highly liquid investments with an original maturity date of 90 days or less. The Partnership does not have holdings in asset backed commercial paper. The Partnership had bank operating lines of credit of \$75.0 million, of which \$27.4 million was reserved for a standby letter of credit issued to BC Hydro.

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.

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.

FOURTH QUARTER 2007 RESULTS

EBITDA for the fourth quarter of 2007 decreased by \$20.9 million from the previous quarter and \$30.3 million when compared to the fourth quarter of 2006. The decrease from the prior quarter is mainly attributable to the impact of the stronger Canadian dollar and a 6% increase in manufacturing costs. The Canadian dollar strengthened significantly during the period with the Bank of Canada noon rate averaging 6.5% higher than the previous quarter and peaking at US\$1.09. The negative impact on operating income from the stronger Canadian dollar was approximately \$12 million when compared to the prior quarter. The increase in manufacturing costs was mainly due to higher energy costs as a result of seasonal increases from winter natural gas usage and price and timing of spending on maintenance. When compared to the prior year quarter the \$30.3 million decrease in EBITDA was primarily due to the impact of the stronger Canadian dollar and higher fibre costs partially offset by increases in NBSK pulp list prices. The impact of

the stronger Canadian dollar was approximately \$28 million when compared to the same period last year. Fourth quarter 2007 fibre costs were in line with the previous quarter and 23% higher than the fourth quarter 2006 with the increase mainly attributable to a higher percentage of whole log chipping to mitigate the impact on residual chip supply from continued sawmill downtime in the interior of British Columbia. Offsetting the stronger Canadian dollar and increased manufacturing costs over the prior year period were increased NBSK pulp list prices of approximately 11%.

NBSK production during the fourth quarter was 2,300 tonnes less than the fourth quarter of 2006. Total downtime taken during the quarter was 12 days compared to 2 days in the fourth quarter of 2006. The Prince George pulp and paper mill and Northwood mill completed scheduled maintenance outages during the fourth quarter of 2007. The decrease in production over the prior year quarter was due to there being no scheduled maintenance downtime in the fourth quarter of 2006.

- Fourth quarter 2007 operating income of the pulp segment decreased by \$31.7 million when compared to the same quarter in the prior year. The results are lower due to the impact of the stronger Canadian dollar, higher fibre costs and one time non-cash adjustments, which were partially offset by increases in NBSK pulp list prices. The impact of the stronger Canadian dollar was approximately \$24 million when compared to the same period last year. Fibre costs increased 23% when compared to the prior year period, mainly attributable to a higher percentage of whole log chipping to mitigate the impact on residual chip supply from continued sawmill downtime in the interior of British Columbia. Offsetting the stronger Canadian dollar and increased fibre costs over the prior year period were increased NBSK pulp list prices of approximately 11%. The non-cash adjustments were comprised of \$1.0 million to fully amortize the asset retirement obligation related to the Intercon ash pond which was decommissioned in the quarter and a \$1.1 million loss on disposal of non operational capital assets.
- The operating loss of the paper segment for the fourth quarter of 2007 was \$0.9 million, \$2.6 million unfavourable variance when compared to the same quarter in 2006. The lower operating earnings were due to a 5% decrease in realized prices in Canadian dollar terms and higher spending on maintenance costs as there was no maintenance downtime in the fourth quarter of 2006.
- Unallocated costs, comprised principally of general and administrative expenses, totalled \$3.4 million in the fourth quarter of 2007 compared to \$3.8 million in the same period last year. Unallocated costs were down slightly when compared to the same period in the prior year mainly due to lower audit related fees.

More detailed analysis of the fourth quarter 2007 results is found in the Fourth Quarter 2007 press release dated February 19, 2007.

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

In addition to the obligations noted in “Financial requirements and Liquidity”, 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.

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.

RISKS AND UNCERTAINTIES RELATED TO THE BUSINESS AND INDUSTRY

Cyclical of Product Prices

The Partnership's financial performance is dependent upon the selling prices of its pulp and paper products, which have fluctuated significantly in the past. The markets for these products are highly cyclical and characterized by (i) periods of excess product supply due to industry capacity additions, increased production and other factors; and (ii) periods of insufficient demand due to weak general economic conditions. The economic climate of each region where the Partnership's products are sold has a significant impact upon the demand, and therefore, the prices for pulp and paper. In particular, the list price of pulp has historically been unpredictable.

Currency Exchange Risk

The Partnership's operating results are sensitive to fluctuations in the exchange rate of the Canadian dollar to the U.S. dollar, as prices for the Partnership's products are denominated in U.S. dollars or linked to prices quoted in U.S. dollars. Therefore, an increase in the value of the Canadian dollar relative to the U.S. dollar reduces the amount of revenue in Canadian dollar terms realized by the Partnership from sales made in U.S. dollars, which in turn, reduces the Partnership's operating margin and the cash flow available to fund distributions.

Dependence on Canfor

Approximately 66% of the fibre currently used by the Partnership is derived from the Fibre Supply Agreement with Canfor. The Partnership's financial results could be materially adversely affected if Canfor is unable to provide the current volume of wood chips as a result of mill closures, whether temporary or permanent.

Raw Material Costs

The principal raw material utilized by the Partnership in its manufacturing operations is wood chips. The Partnership's Fibre Supply Agreement with Canfor contains a pricing formula that currently results in the Partnership paying market prices for wood chips and contains provisions to adjust the pricing formula to reflect market conditions. Prices for wood chips are not within the Partnership's control and are driven by market demand, product availability, environmental restrictions, logging regulations, the imposition of fees or other restrictions on exports of lumber into the U.S. and other matters. The Partnership is not always able to increase the selling prices of its products in response to increases in raw material costs.

Competitive Markets

The Partnership's products are sold primarily in North America, Europe, and Asia. The markets for the Partnership's products are highly competitive on a global basis, with a number of major companies competing in each market with no company holding a dominant position. Competitive factors include quality of product, reliability of supply and customer service. The Partnership's competitive position is influenced by the availability, quality and cost of raw

materials, energy and labour costs, free access to markets, currency exchange rates, plant deficiencies and productivity in relation to its competitors.

Dependence on Key Customers

In 2007, the Partnership's largest customer accounted for approximately 24% of its pulp sales. The Partnership is, therefore, dependent on this key customer. While the Partnership's relationship with this customer is long-standing and the sales agreement with this customer is evergreen with a three-year notice period required to terminate the Agreement, in the event that the Partnership cannot maintain this customer or the demand from this customer diminishes for any reason in the future, there is a risk that the Partnership would be forced to find alternative markets in which to sell its pulp, which, in turn, could result in lower prices or increased distribution costs thereby adversely affecting its sales margins and distributable cash.

Increased Production Capacity

The Partnership currently faces substantial competition in the pulp industry and may face increased competition in the years to come if new manufacturing facilities are built or existing mills are improved. If increases in pulp production capacity exceed increases in pulp demand, selling prices for pulp could decline and adversely affect the Partnership's business, financial condition, results of operation and cash flows, and the Partnership may not be able to compete with competitors who have greater financial resources and who are better able to weather a prolonged decline in prices.

Obligations to BC Hydro

Under the Cogeneration Agreement with BC Hydro, if the cogeneration project generates less than 390 GWh in any year and the shortfall cannot be made up by excess generation of up to 390 GWh in prior years or excess generation in the subsequent year, the Partnership is required to pay BC Hydro an amount equal to \$3.06 million multiplied by the ratio of the uncorrected shortfall to the annual requirement of 390 GWh.

Maintenance Obligations and Facility Disruptions

The Partnership's manufacturing processes are vulnerable to operational problems that can impair the Partnership's ability to manufacture its products. The Partnership could experience a breakdown in any of its machines, or other important equipment, and from time to time the Partnership schedules planned and unplanned outages to conduct maintenance that cannot be performed safely or efficiently during operations. Such disruptions could cause significant loss of production, which could have a material adverse effect on the Partnership's business, financial condition and operating results.

Governmental Regulation

The Partnership is subject to a wide range of general and industry-specific environmental, health and safety and other laws and regulations imposed by federal, provincial and local authorities. If the Partnership is unable to extend or renew a material approval, license or permit required by such laws, or if there is a delay in renewing any material approval, license or permit, the Partnership's business, financial condition, results of operations and cash flows could be materially adversely affected. In addition, future events such as any changes in these laws and regulations or any change in their interpretation or enforcement, or the discovery of currently unknown conditions, may give rise to unexpected expenditures or liabilities.

Capital Requirements

The pulp and paper industries are capital intensive, and the Partnership regularly incurs capital expenditures to expand its operations, maintain its equipment, increase its operating efficiency and comply with environmental laws. The Partnership's total capital expenditures, net of non-cash increases in asset retirement obligations, was approximately \$30 million during 2007, and it expects to spend about \$30 million on capital expenditures during 2008. The Partnership anticipates available cash resources and cash generated from operations will be sufficient to fund its operating needs and capital expenditures.

Work Stoppages

Any labour disruptions and any costs associated with labour disruptions at the Partnership's mills could have a material adverse effect on the Partnership's production levels and results of operations. The Partnership's collective agreements with the CEP and PPWC have terms expiring on April 30, 2008. Any future inability to negotiate acceptable contracts could result in a strike or work stoppage by the affected workers and increased operating costs as a result of higher wages or benefits paid to unionized workers.

Native Land Claims

Much of the fibre used by the Partnership is sourced from areas, which are located within areas where there are claims of Aboriginal rights and title. The courts have held that the Crown has an obligation to consult aboriginal people, and accommodate their concerns, where there is a reasonable possibility that a Crown-authorized activity, such as public forest tenure, may infringe asserted Aboriginal rights or title, even if those claims have not yet been proven. If the Crown has not consulted and accommodated aboriginal people as required, the courts may quash a tenure or attach conditions to the exercise of harvesting rights under the tenure that may affect the quantity of fibre that can be harvested from such tenure.

Transportation Services

The Partnership relies primarily on third parties for transportation of its products, as well as delivery of raw materials principally by railroad, trucks and ships. If any of the Partnership's third party transportation providers were to fail to deliver the raw materials or products or distribute them in a timely manner, the Partnership may be unable to sell those products at full value, or at all, or unable to manufacture its products in response to customer demand and have a material adverse effect on its financial condition and operating results. In addition, if any of these third parties were to cease operations or cease doing business with the Partnership, the Partnership may be unable to replace them at reasonable cost.

Senior Management

The Partnership's success depends, in part, on the efforts of its senior management. The senior management team, led by Paul Richards, President and CEO, has significant industry experience and would be difficult to replace. Members of the senior management team possess sales, marketing, engineering, manufacturing, financial and administrative skills that are critical to the operation of the Partnership's business. If the Partnership loses or suffers an extended interruption in the services of one or more of its other senior officers, the Partnership may become unable to implement its business strategy, resulting in lower profitability. Moreover, the market for qualified individuals is highly competitive, and the Partnership may not be able to attract and retain qualified personnel to replace or succeed members of senior management should the need arise. The Partnership does not maintain any key-man or similar insurance policies covering any of its senior management.

Environmental Laws, Regulations and Compliance

The Partnership is subject to a wide range of general and industry-specific laws and regulations relating to the protection of the environment, including those governing air emissions, wastewater discharges, the storage, management and disposal of hazardous substances and wastes, the cleanup of contaminated sites, landfill operation and closure obligations, and health and safety matters. These laws and regulations require us to obtain authorizations from and comply with the authorization requirements of the appropriate governmental authorities, which have considerable discretion over the terms and timing of permits.

The Partnership has incurred, and expects to continue to incur, capital, operating and other expenditures complying with applicable environmental laws and regulations and as a result of environmental remediation on asset retirement obligations. The provision for these future environmental remediation expenditures was \$11.3 million as of December 31, 2007 (see note 8 of the accompanying consolidated financial statements). It is possible that the Partnership could incur substantial costs, such as civil or criminal fines, sanctions and enforcement actions, cleanup and closure costs, and third-party claims for property damage and personal injury as a result of violations of, or liabilities under, environmental laws and regulations. The amount and timing of environmental expenditures is difficult to predict, and, in some cases, our liability may exceed forecasted amounts. The discovery of additional contamination or the

imposition of additional cleanup obligations at our or third-party sites may result in significant additional costs. Any material expenditure incurred could adversely impact our financial condition or preclude us from making capital expenditures that would otherwise benefit our business. Enactment of new environmental laws or regulations or changes in existing laws or regulations, or interpretation thereof, could have a significant impact on the Partnership.

Sensitivities

In addition, the sensitivity of Partnership's results to currency fluctuations and price changes for its principal products and input costs, when operating at full capacity, is estimated to be as follows:

(millions of dollars, unaudited)	Impact on annual Net income
Canadian dollar – US \$0.01 change per Canadian dollar	\$ 7
NBSK pulp – US \$10 change per tonne	9
Natural gas cost - \$1 change per gigajoule	4
Chip cost - \$2 change per tonne	5

CRITICAL ACCOUNTING 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 recorded in the financial statements. On an ongoing basis, management reviews its estimates, including those related to useful lives for amortization, impairment of long-lived assets, pension and other employee future benefit plans and asset retirement obligations based upon currently available information. While it is reasonably possible that circumstances may arise which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect the Partnership's financial condition.

CHANGES IN ACCOUNTING POLICIES

Employee Future Benefits

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. The Partnership ceased to account for these pension costs on the basis of a multi-employer plan and has 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 accounting policy is detailed in notes 3 and 7 of the Partnership's unaudited interim consolidated financial statements.

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 for 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 cash and cash equivalents as held-for-trading. Accounts receivable are classified as loans and receivables. Bank indebtedness, accounts payable and

accrued charges, 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 of the Partnership’s unaudited interim consolidated financial statements).

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 Partnership’s equity that results from transactions, events and circumstances from sources other than the Partners. For the quarter ended March 31, 2007, the Partnership recorded the reversal of unrealized losses on derivative instruments outstanding at December 31, 2006 in other comprehensive income. These derivative instruments had previously been accounted for as cash flow hedges and recorded in accordance with hedge accounting.

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 Opening Partners’ Equity at January 1, 2007.

Asset Retirement Obligations

The Partnership maintains several ash ponds and landfills to dispose of fly ash from the power boilers. During the quarter ended September 30, 2007, the Partnership recognized asset retirement obligations in respect of landfill closure and post-closure monitoring costs. The change reflected new information on all sites concerning the estimated timing of closure and closure alternatives. As a result, the Partnership has an obligation based on the fair value of the landfill closure costs of \$9.1 million with a corresponding capital addition to the related assets. This estimate is based on expected closure of the respective mill landfills occurring in periods ranging from 10 to 25 years.

During the second quarter of 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 has 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 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.

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.

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 Partnership’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.

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.

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. Entities 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.

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 2006, the Partnership had unrealized losses on outstanding natural gas swaps totalling \$0.8 million and pulp swaps totalling \$1.0 million. These instruments were previously recorded using hedge accounting and were measured at fair value on January 1, 2007 with a corresponding adjustment through accumulated other comprehensive income.

OUTSTANDING UNITS

At February 19, 2008, there were 71,270,025 Limited Partnership Units outstanding, of which 35,493,542 units (consisting of 14,254,005 Class A Limited Partnership Units and 21,239,537 Class B Limited Partnership Units) are owned by the Fund through Canfor Pulp Trust and 35,776,483 Class B Exchangeable Limited Partnership Units are owned indirectly by Canfor.

DISCLOSURE CONTROLS

The Partnership has established disclosure controls and procedures to provide reasonable assurance that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board and the Audit Committee of the general partner and the Audit Committee and

Trustees of the Fund. The Partnership's Chief Executive Officer and Chief Financial Officer have evaluated and are satisfied with the effectiveness of these disclosure controls and procedures for the period ending December 31, 2007.

INTERNAL CONTROLS

During 2007 there were no changes to our internal controls over financial reporting that occurred that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

ADDITIONAL INFORMATION

Additional information about Canfor Pulp Income Fund and Canfor Pulp Limited Partnership, including the Annual Information Form, is available at www.sedar.com or www.canforpulp.com.

CANFOR PULP LIMITED PARTNERSHIP
SUPPLEMENTARY FINANCIAL INFORMATION

(millions of dollars, unaudited)	Year ended	
	December 31, 2007	December 31, 2006
RECONCILIATION OF NET INCOME TO EBITDA		
Net Income	\$ 129.8	\$ 123.0
Add (deduct):		
Amortization	52.8	49.0
Net interest expense	6.7	3.8
Unrealized foreign exchange loss (gain) on long-term debt	(19.5)	2.5
Unrealized loss on derivative instruments	3.3	-
Foreign exchange loss (gain) on working capital	13.8	(3.9)
Loss on disposal of fixed assets	1.1	-
Other expense (income)	0.5	(0.1)
Business acquisition costs	-	5.9
EBITDA	\$ 188.5	\$ 180.2

(millions of dollars, unaudited)	Year ended December 31, 2007		Six months Ended ¹ December 31, 2006
	CALCULATION OF STANDARDIZED AND ADJUSTED DISTRIBUTABLE CASH		
Cash flow from operating activities	\$ 149.7	\$ 99.9	
Deduct: Capital expenditures – cash	(23.8)	(11.1)	
Standardized distributable cash	\$ 125.9	\$ 88.8	
Adjustments to standardized distributable cash:			
Add (deduct):			
Increase in non-cash working capital	25.0	22.8	
Capital expenditures – accruals	(8.1)	-	
Financing Costs	-	(1.6)	
Salary pension plan contribution ²	(3.4)	-	
Adjusted distributable cash	\$ 139.4	\$ 110.0	
Standardized distributable cash – per unit (in dollars)	\$ 1.77	\$ 1.25	
Adjusted distributable cash – per unit (in dollars)	\$ 1.96	\$ 1.54	
Cash distributions declared (paid and payable)	131.1	88.5	
Cash distributions declared – per unit (in dollars)	\$ 1.84	\$ 1.24	

Notes: ¹ For the purposes of presenting Standardized Distributable cash, Adjusted Distributable cash and Cash Distributions, the 2006 comparative figures are for the six months ended December 31, 2006, as the Partnership did not exist prior to July 1, 2006, and as a result there were no cash distributions made prior to July 1, 2006.

² \$3.4 million pension contribution representing a payment above the normal funding requirements which was used to reduce the 2006 taxable income of the Partnership.

STANDARDIZED DISTRIBUTABLE CASH AND CASH DISTRIBUTIONS

In accordance with the Canadian Institute of Chartered Accountants July 2007 interpretive release “Standardized Distributable Cash in Income Trusts and other Flow-Through Entities”, the Partnership has adopted the distributable cash calculation which conforms with the current guidance. In summary, for the purposes of the Partnership, standardized distributable cash is defined as the periodic cash flows from operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital less total capital expenditures as reported in the GAAP financial statements.

Management determines the level of cash distributions based on the level of cash flow from operations before working capital changes less actual and planned capital expenditures, a reserve for future major capital replacements (estimated at \$4 million per year) and a contingency reserve. During the year distributions are based on estimates of full year cash flow and capital spending; thus distributions may be adjusted as these estimates change. It is expected

that normal seasonal fluctuations in working capital will be funded from cash resources or the revolving short-term credit facility, and thus will not significantly affect the level of distributions.

Distributions are declared monthly with date of record on the last day of the month and payable within 15 days following. The Partnership began active operation, including monthly distributions, in July 2006 and thus there were no distributions prior to that date.