

Canfor Pulp Income Fund and Canfor Pulp Limited Partnership Third Quarter 2006 – Report to Unitholders Management’s Discussion and Analysis

Canfor Pulp Income Fund (the Fund) earns income from its 20% 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 unaudited interim financial statements, with accompanying notes are presented for both the Fund and the Partnership. In addition, this Management’s Discussion and Analysis (MD&A) provides a review of the significant developments that have impacted the Partnership’s performance, and therefore the Fund performance, during the third quarter of 2006 relative to the previous quarter and relative to the comparative quarter in 2005. 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 Canfor Corporation (Canfor), which the Partnership acquired on July 1, 2006. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes, as well as the MD&A and audited consolidated financial statements and notes which were included in Canfor’s Information Circular dated April 28, 2006. (available at www.canforpulp.com and www.sedar.com) and Canfor’s Annual Report available on www.canfor.com

Factors that could impact future operations are also discussed. These factors may be influenced by known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. Factors that could have a material impact on any future-oriented statements made herein include, but are not limited to: 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 Partnership.

In this document, references are made to EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization or operating income before amortization) and 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. Distributable cash is a measure of cash flow used by management to determine level of cash distributions. EBITDA and 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 distributable cash are provided in a schedule at the end of this MD&A.

The information in this report is as at October 23, 2006.

All financial references are in millions of Canadian dollars unless otherwise noted.

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 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.

On July 1, 2006, the Fund completed the indirect acquisition of 20% of the Prince George, B.C. based NBSK pulp and paper business of Canfor. Canfor exchanged 14,254,005 million Class A Limited Partnership Units for an equal number of Fund Units and these units were then distributed by Canfor to its shareholders. As a result of these transactions, on July 1, 2006, Canfor shareholders owned all of the issued and outstanding Fund Units, and the Fund held all issued and outstanding Class A Limited Partnership Units representing a 20% indirect interest in the Partnership. Canfor, through its ownership of Class B Exchangeable Limited Partnership Units, which are indirectly exchangeable for Fund Units, owns the remaining 80% interest in the Partnership.

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

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.

OPERATING RESULTS AND LIQUIDITY

For the three month period ended September 30, 2006, the Fund had earnings of \$8.4 million, or \$0.59 per unit, representing its share of earnings of the Partnership for the period. Distributions declared by the Partnership and accruing to the Fund were \$6.3 million or which \$2.9 million was receivable at quarter end. Cash distributions received from the Partnership are the only source of liquidity for the Fund. The Fund's requirements of administrative services are minimal and are provided by the Partnership. Operating expenses reflect fees paid to third parties.

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 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 third quarter the Fund declared distributions of \$0.44 per unit or a total of \$6.3 million.

UNITS

At September 30, 2006, throughout the quarter and as of the date of this report, the Fund had 14,254,005 units outstanding.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management of the Fund will regularly review its estimates and assumptions based on historical experience and other factors that it believes would result in reasonable estimates. Actual results could differ from those estimates under different assumptions. The following accounting policy requires significant judgment by management.

Investments

The valuation of the Fund's investment in the Partnership will be regularly reviewed by management to ensure that any decline in the market value that is considered other than temporary will be reflected in the carrying value of the investment. In making the assessment, several factors will be considered including the amount by which the carrying value exceeds the market value, the duration of any market value decline and expected future cash flows from the Partnership.

RISKS AND UNCERTAINTIES

The risk factors and uncertainties of the Fund are derived from its investment in the Partnership and thus the risks and uncertainties of the Partnership are also applicable to the Fund. A comprehensive discussion of these can be found in the MD&A of the Partnership and also in the April 28, 2006 Information Circular issued by Canfor and available at www.canforpulp.com or www.sedar.com.

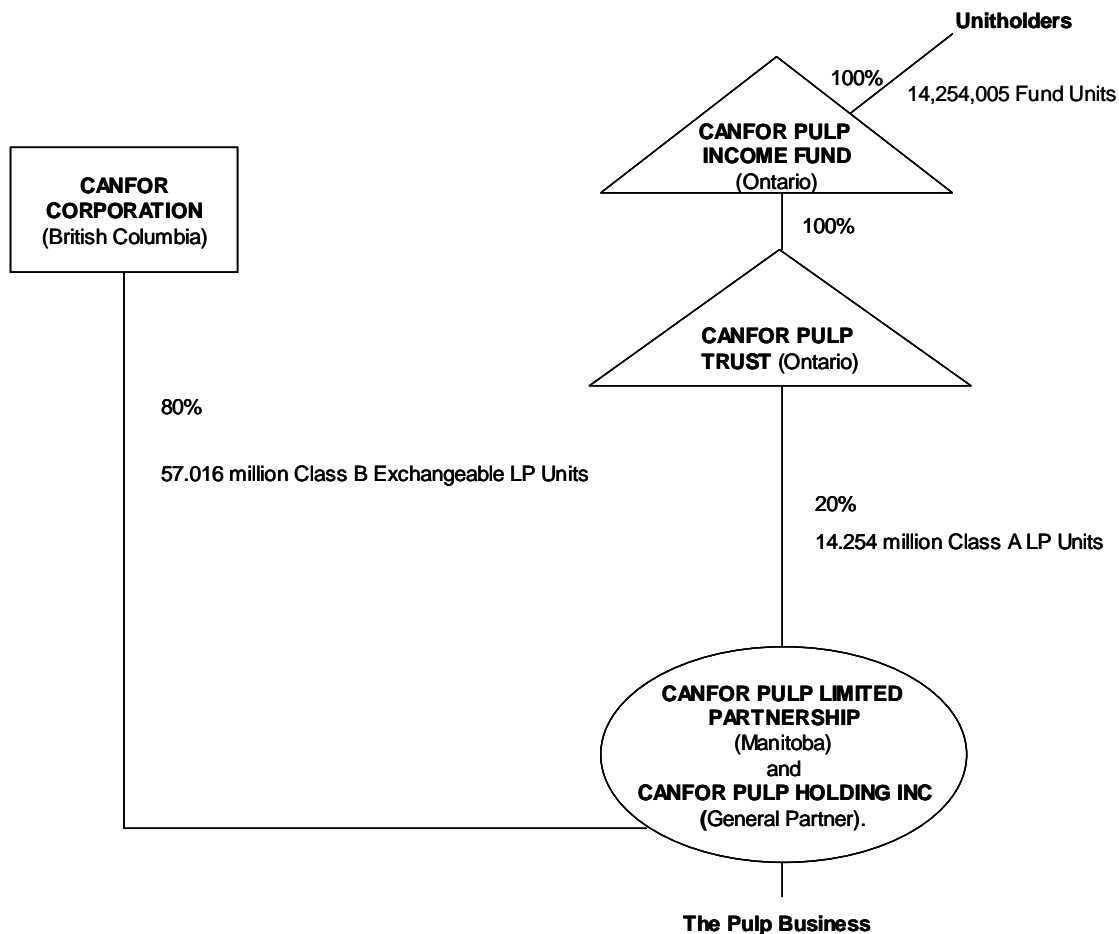
Canfor Pulp Limited Partnership

Creation of the Partnership and the Spinout Transaction

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

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units (the Spinout). Canfor then exchanged its Class A Limited Partnership Units for an equal number of Units of Canfor Pulp Income Fund (the Fund). Upon the completion of the Spinout, Canfor shareholders were entitled to receive one New Common Share of Canfor and 0.1 of a Unit of the Fund (Fund Unit), with the distribution of the Fund Units being structured as a return of capital on the Canfor Shares. As a result, on the date of the Spinout Canfor shareholders owned all of the issued and outstanding Fund Units, with the outstanding Fund Units representing a 20% indirect interest in the Partnership and through it the Pulp Business. Through its interest in the Partnership, which is indirectly exchangeable for Fund Units, Canfor owns the remaining 80% interest in the Pulp Business. 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



The Partnership and Canfor have entered into a long-term fibre supply agreement under which Canfor provides the Partnership with residual wood chips and hog fuel produced at certain of its sawmills at market prices. The Partnership also purchases, at cost, a number of administrative, accounting, legal and management services from Canfor under a Partnership Services Agreement which can be terminated, in whole or in part, on 12 months notice. The Partnership also provides ongoing marketing services to Canfor, acting as a selling representative on behalf of Howe Sound Pulp and Paper Limited Partnership and for Canfor's Taylor Pulp operations.

SUMMARY OF SELECTED PARTNERSHIP RESULTS

(millions of dollars, except for per unit amounts)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Sales	214.3	194.9	605.4	193.1	575.2
EBITDA	62.5	26.8	122.2	9.2	34.9
Operating income (loss)	49.7	15.7	85.8	(3.1)	-
Net income (loss)	41.9	15.9	78.3	(3.1)	(0.1)
Per Partnership unit, basic and diluted					
Net income (loss)	0.59	0.22	1.10	(0.04)	-
EBITDA	0.88	0.38	1.72	0.13	0.49
Average Canadian/US exchange rate ¹	0.892	0.891	0.883	0.832	0.817

EBITDA increased by \$35.7 million over the previous quarter, and was \$53.3 million better than in the same quarter in 2005. A strong market for NBSK pulp, which resulted in our net realized prices in Canadian dollar terms increasing by 10% during the third quarter and by 20% when compared to same quarter a year ago, combined with increased productivity and lower maintenance spending were the main reasons for the improved profitability.

OPERATING RESULTS BY BUSINESS SEGMENT

Pulp

(millions of dollars unless otherwise noted)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Sales	187.4	167.8	523.3	164.4	485.5
EBITDA	64.3	31.8	132.0	11.6	44.8
EBITDA margin	34%	19%	25%	7%	9%
Operating income (loss)	52.5	21.6	98.5	0.3	12.7
Average pulp price – US \$ ²	711	670	668	588	614
Average pulp price in Cdn \$	797	752	756	707	752
Production – pulp (000 mt)	257.5	227.8	751.7	246.0	727.8
Shipments – Partnership-produced pulp (000 mt)	251.4	244.6	751.7	257.9	721.4
<i>Marketed on behalf of HSLP & Canfor (000 mt)</i>	142.7	142.4	427.7	138.3	423.7

Operating income of the pulp segment improved by \$30.9 million from the previous quarter and \$52.2 million when compared to the same quarter last year. The increase from the prior quarter is mainly due to improved NBSK pricing

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

² Per tonne, delivered to Northern Europe

and higher production volumes as a result of the annual maintenance shutdowns at all facilities in the prior quarter. When compared to the third quarter of 2005, improved NBSK price, higher production and the beneficial impact of lower chip prices were partially offset by the negative effect of a stronger Canadian dollar.

Operations

NBSK production during the third quarter was higher by 29,700 tonnes over the prior quarter and 11,500 tonnes over the same quarter in 2005. In the current quarter operations at the Northwood and Prince George pulp mills were impacted by the direct and residual effects of several lightning strikes resulting in major power failures. This resulted in a loss of approximately 7,700 tonnes of production during the quarter. In prior periods, scheduled annual maintenance and other downtime reduced production by 37,700 tonnes in the second quarter of 2006 and in the third quarter of 2005 scheduled maintenance downtime and a slow-back of the Prince George pulp mill due to precipitator performance issues resulted in lost production of 16,000 tonnes.

The cogeneration facility at the Prince George pulp mill averaged 968 megawatt hours per day compared to 973 in the prior quarter and 880 in the same period last year. This represents 88% of the target rate and planned improvements with hog fuel feed and ash handling systems are expected to improve performance over the next several quarters.

Markets

The chemical market pulp industry continued to experience strong demand during the third quarter of 2006. This was partly driven by modest demand growth in the printing and writing paper segment³ but mostly due to the large reduction in Canadian NBSK production capacity (approximately 1 million tonnes or 16% of Canadian capacity has shut in 2006)³. The capacity reduction is driven primarily by mill closures in Eastern Canada due to high fibre and energy costs and the strengthening Canadian dollar.

Historically, the industry experiences increases in inventories during the third quarter as demand is normally below the average and pulp mills run at full production rates during the summer months. However, inventory levels for NBSK pulp, the grade manufactured and sold by the Partnership, rose by just one day, to 26 days of supply³. An inventory level of 30 days of supply is considered as a balanced market.

These market dynamics have translated into a very positive pricing environment for NBSK pulp. The benchmark price into Northern Europe stood at US\$690 per tonne at the end of June 2006, rose to US\$710 during the quarter and going into the fourth quarter our list price into Northern Europe was US\$730 per tonne. Prices for delivery to the United States and Asia increased at a faster pace than those in Europe. Current list price for delivery to the United States is US\$770 per tonne (a US\$50 increase since June 30) and is US\$690-730 in Asia (a US\$60 increase since June 30).

Outlook – Pulp Markets

The outlook for the fourth quarter is generally positive, as NBSK pulp inventories are low and prices remain strong around the world with a price increase announced for European and Asian deliveries. The market is expected to carry its current momentum into next year.

³ Pulp and Paper Products Council

Paper

(millions of dollars unless otherwise noted)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Sales	26.9	27.2	82.1	28.7	89.7
EBITDA	2.0	0.1	3.8	0.9	4.4
EBITDA margin	8%	-	5%	3%	5%
Operating income (loss)	1.0	(0.8)	1.0	(0.1)	1.5
Production – paper (000 mt)	32.0	30.1	95.2	31.6	95.9
Shipments – paper (000 mt)	32.9	31.3	95.3	31.1	96.6

Operating income of the paper segment improved by \$1.8 million from the previous quarter and \$1.1 million when compared to the same quarter last year. Net realized price in US dollars increased by 3% over the prior quarter and 6% over the same period a year ago. Price increases were partially offset by the strengthening Canadian dollar and higher costs for slush pulp, which is transferred at market price.

Operations

Paper production during the third quarter was higher by 1,948 tonnes over the prior quarter and 435 tonnes more than the same quarter in 2005. The increase over the prior quarter is primarily the result of maintenance downtime taken in the second quarter. Operations continue to focus on higher margin bleached paper production, which averaged 72% in the quarter compared to 71% in the prior quarter and 74% for the same period in 2005.

Markets

Demand remained steady in the quarter with sales matching production. A US\$25 price increase was announced and implemented in North America for all grades. However, European prices remain flat, which supports the continued focus of growing bleached sales in North America.

Outlook – Paper Markets

Prices are expected to remain at current levels, even though demand is expected to weaken due to the historical seasonal slowdown.

Non-Segmented Items

(millions of dollars)	Q3 2006	Q2 2006	YTD 2006	Q3 2005	YTD 2005
Unallocated costs	3.9	5.1	13.7	3.3	14.2
Business acquisition costs	5.9	-	5.9	-	-
Net interest expense	1.8	-	1.8	-	-
	11.6	5.1	21.4	3.3	14.2

Unallocated Costs

Unallocated costs, comprised principally of general and administrative expenses, totalled \$3.9 million in the third quarter compared to \$5.1 million in the prior quarter and \$3.3 million in the same period last year. Actual costs were lower than costs in the comparative periods as a result of lower corporate costs. The corporate costs in comparative periods primarily represent allocations of Canfor's corporate administration, legal services, human resources, treasury services and incentive plan amounts. These were based on estimates of the pulp businesses share of Canfor's corporate costs. Unallocated costs in 2005 were reduced by a refund of provincial sales tax of \$1.1 million.

Business Acquisition Costs

The Partnership incurred cost related to its initial organization and the acquisition of the Pulp Business from Canfor, fully described in Note 1, principally comprised of legal, accounting, audit and consulting fees.

Interest Expense

Net interest expense of \$1.8 million during the third quarter represents interest at prime rate plus 0.5% to Canfor for borrowing under the \$125 million promissory note net of interest earned on cash and temporary investments. No interest expense is shown for prior periods since the Pulp Business was an integral part of Canfor and interest was not allocated to it.

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)	Q3 2006	YTD 2006	Q3 2005	YTD 2005
Ratio of current assets to current liabilities	1.07	1.07	2.20	2.20
Ratio of net debt to common partners' equity	0.18	0.18	-	-
Increase (decrease) in cash and cash equivalents	13.3	15.8	(0.8)	(1.0)
– comprised of cash flow from (used in):				
Operating activities	36.4	104.7	32.0	27.3
Financing activities	-	(57.3)	(27.2)	21.5
Investing activities	(23.1)	(31.6)	(5.6)	(49.8)

Changes in Financial Position

Operating activities generated \$36.4 million in cash in the third quarter, which was a \$4.4 million improvement over same period last year.

Cash flows from financing activities represent net cash transactions with Canfor prior to the spinout. Prior to the acquisition the pulp business operating transactions such as sales of products, and purchases of products and services, were settled in the divisional equity account as they occurred. The excess cash flows of the pulp business were transferred to the central cash management system of Canfor.

The \$23.1 million of cash used in investing activities in the quarter represents \$17.1 million of distributions paid to Canfor and fund unit holders, with the balance relating to capital expenditures.

Liquidity and Financial Requirements

At September 30, 2006, the Partnership had two credit facilities provided by Canfor, a revolving operating line of \$50 million and a fully drawn \$125 million non-revolving advance evidenced by a promissory note. Of the operating line, \$33.9 million was used to provide a letter of credit to BC Hydro related to the cogeneration project. Interest rates and fees charged by Canfor are equivalent to commercial rates. The Partnership is currently negotiating with commercial and private lenders to replace both credit facilities, with closing expected during the fourth quarter.

TRANSACTIONS WITH RELATED PARTIES

The Partnership is controlled by, and has a commercial relationship with, Canfor. The nature and extent of the transactions with Canfor are fully described in note 9 of the unaudited interim financial statements of the Partnership. The most important contractual arrangement is the long term fibre agreement, under which Canfor supplies approximately 70% of the wood chip volume consumed by Partnership's pulp mills.

OUTSTANDING UNITS

At October 24, 2006, and during the third quarter, there were a total of 71,270,025 limited partnership units outstanding, consisting of 14,254,005 Class A units owned by the Fund through Canfor Pulp Trust and 57,016,020 Class B exchangeable units owned indirectly by Canfor.

RISKS AND UNCERTAINTIES

A comprehensive discussion of Risks and Uncertainties was included in the April 28, 2006 Information Circular issued by Canfor and available at www.canforpulp.com or www.sedar.com. In addition a potential risk is the reduction in chip supply as sawmills take down time to cope with extremely low lumber prices.

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

(millions of dollars)	Impact on annual Net income
Canadian dollar – US \$0.01 change per Canadian dollar	\$ 5
NBSK pulp – US \$10 change per tonne	8
Natural gas cost - \$1 change per gigajoule	4
Chip cost - \$10 change per tonne	24

SELECTED QUARTERLY FINANCIAL INFORMATION

	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
	2006	2006	2006	2005	2005	2005	2005	2004
Sales and Income (millions of dollars)								
Sales	214.3	194.9	196.1	195.9	193.1	198.9	183.3	200.9
Operating income (loss)	49.7	15.7	20.5	16.7	(3.1)	(5.2)	8.3	(11.9)
EBITDA	62.5	26.8	32.9	29.0	9.2	5.9	19.9	0.3
Net income (loss)	41.9	15.9	20.4	16.6	(3.1)	(5.2)	8.2	(11.8)
Per Partnership unit (dollars)								
Net income (loss), basic	0.59	0.22	0.29	0.23	(0.04)	(0.07)	0.12	(0.17)
Statistics								
Pulp shipments (000 mt)	251.4	244.6	255.7	260.7	257.9	246.8	216.7	268.6
Paper shipments (000 mt)	32.5	31.3	31.1	30.6	31.1	33.0	32.5	31.0
Average exchange rate (Cdn\$/US\$)	0.896	0.890	0.870	0.856	0.826	0.809	0.814	0.817
Average NBSK final pulp price delivered to Northern Europe (US \$)	711	670	622	600	588	613	642	609

Sales are primarily influenced by changes in market pulp prices and fluctuations in Canadian/US dollar exchange rates. Operating income, net income and EBITDA are primarily impacted by sales and price fluctuations in raw material inputs, energy prices and maintenance costs.

DISCLOSURE CONTROLS

The Partnership has established disclosure controls and procedures to ensure 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.

SUPPLEMENTARY FINANCIAL INFORMATION

(millions of dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2006	2005	2006	2005
RECONCILIATION OF NET INCOME (LOSS) TO EBITDA				
Net Income (loss)	\$ 41.9	(3.1)	\$ 78.3	(0.1)
Add:				
Amortization	12.8	12.2	36.4	34.9
Interest	1.8	-	1.8	-
Business acquisition costs and Other	6.0	0.1	5.7	0.1
EBITDA (operating income before interest and amortization)	\$ 62.5	9.2	\$ 122.2	34.9
CALCULATION OF DISTRIBUTABLE CASH				
Cash flow from operating activities	\$ 36.4	32.0	\$ 104.7	27.3
Change in working capital	19.8	(22.1)	15.7	9.8
Deduct:				
Capital expenditures	(6.1)	(5.6)	(14.5)	(49.7)
Distributable cash	\$ 50.1	4.3	\$ 105.9	(12.6)
Distributable cash – per partnership unit (in dollars)	\$ 0.70	n/a	\$ 1.44	n/a
Cash distributions declared (paid and payable)	31.4			
Cash distributions declared – per partnership unit (in dollars)	\$ 0.44	n/a	\$ n/a	n/a

DISTRIBUTABLE CASH AND CASH DISTRIBUTIONS

The Board of Directors 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 and thus distributions may be adjusted as these estimates change. Capital expenditures during 2006, including the second half of the year, will be well below the level normally expected for the business and as a result the reserve for capital expenditures for the balance of the year will be increased to provide a reserve for spending in future periods. It is expected that normal seasonal fluctuations in working capital will be funded from a revolving short-term credit facility and thus will not significantly affect the level of distributions.

Distributions are declared on a monthly basis with record date on the last day of the month and payable within 15 days following. The Partnership began active operation in July 2006, including monthly distributions, and thus there were no distributions in prior periods and no distributions will be paid for earnings from prior periods. The calculation of distributable cash in the table above for any periods prior to July 1, 2006 is provided for information purposes only.

EBITDA and distributable cash are not measures determined in accordance with Canadian generally accepted accounting principles and should not be considered as alternatives to net income or cash flow from operations. As there is no standardized method of calculating EBITDA or distributable cash, the Partnership's use of these terms may not be directly comparable with similarly titled measures used by other companies or income funds.