

**CANFOR PULP INCOME FUND**  
**CANFOR PULP LIMITED PARTNERSHIP**

Interim Consolidated Financial Statements

For the three months ended March 31, 2007

(Unaudited)

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

|   | <b>3 months ended</b> |                   |
|---|-----------------------|-------------------|
| <small>(thousands of dollars, except unit and per unit amounts, unaudited)</small>          | <b>March 31, 2007</b> |                   |
| <b>Income</b>   |                       |                   |
| Equity income in Canfor Pulp Limited Partnership  | \$                    | <b>24,203</b>     |
| <hr/>   |                       |                   |
| <b>Net Income</b>   |                       | <b>24,203</b>     |
| Distributions declared (note 4)   |                       | <b>(14,907)</b>   |
| <hr/>   |                       |                   |
| Earnings in excess of distributions   | \$                    | <b>9,296</b>      |
| <hr/>   |                       |                   |
| <b>Weighted average number of units</b>   |                       | <b>35,493,542</b> |
| <hr/>   |                       |                   |
| <b>Net income per unit, basic and diluted (in dollars)</b>                                  | \$                    | <b>0.68</b>       |
| <hr/>   |                       |                   |
| Net income for the period   | \$                    | <b>24,203</b>     |
| Other comprehensive income  |                       |                   |
| Equity interest in other comprehensive income of Canfor Pulp Limited Partnership            |                       | <b>980</b>        |
| <b>Comprehensive Income</b>   | \$                    | <b>25,183</b>     |
| <hr/>   |                       |                   |
| <b>Accumulated Earnings and Distributions</b>   |                       |                   |
| Balance, beginning of period – Accumulated distributions in excess of earnings              | \$                    | <b>(9,861)</b>    |
| Accounting policy change (note 2)   |                       | <b>2,363</b>      |
| <hr/>   |                       |                   |
| Balance, beginning of period – Accumulated distributions in excess of earnings, as restated |                       | <b>(7,498)</b>    |
| Earnings in excess of distributions - during the period                                     |                       | <b>9,296</b>      |
| <hr/>   |                       |                   |
| <b>Balance, end of period – Accumulated earnings in excess of distributions</b>             | \$                    | <b>1,798</b>      |

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

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

|  | <b>3 months ended<br/>March 31, 2007</b> |
|--|--|
| <hr/> (thousands of dollars, unaudited) <hr/>                            |  |
| <b>Cash generated from (used in)</b>                                     |  |
| <b>Operating activities</b>  |  |
| Net income   | \$ 24,203                                |
| Items not affecting cash:  |  |
| Equity income in Canfor Pulp Limited Partnership                         | (24,203)                                 |
|  | <hr/> -                                  |
| <b>Financing activities</b>  |  |
| Distributions paid to Unitholders (note 4)                               | \$ (22,716)                              |
|  | <hr/>                                    |
| <b>Investing activities</b>  |  |
| Distributions received from Canfor Pulp Limited Partnership              | 22,716                                   |
|  | <hr/>                                    |
| <b>Beginning, change and ending balance in cash and cash equivalents</b> | <hr/> \$ - <hr/>                         |

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

**Canfor Pulp Income Fund  
Consolidated Balance Sheets**

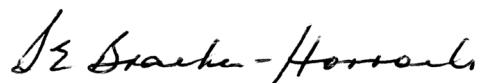
| (thousands of dollars, unaudited)                                    | As at<br>March 31, 2007 | As at<br>December 31, 2006 |
|--|-------------------------|----------------------------|
| <b>ASSETS</b>  |                         |                            |
| <b>Current Assets</b>  |                         |                            |
| Distributions receivable from Canfor Pulp Limited Partnership        | \$ 4,969                | 12,778                     |
| <b>Total current assets</b>  | <b>4,969</b>            | <b>12,778</b>              |
| <b>Equity Investment in Canfor Pulp Limited Partnership (note 3)</b> | <b>301,214</b>          | <b>289,490</b>             |
|  | <b>\$ 306,183</b>       | <b>302,268</b>             |
| <b>LIABILITIES</b>   |                         |                            |
| <b>Current Liabilities</b>   |                         |                            |
| Distribution payable (note 4)  | 4,969                   | 12,778                     |
| <b>Total current liabilities</b>                                     | <b>4,969</b>            | <b>12,778</b>              |
| <b>UNITHOLDERS' EQUITY</b>   |                         |                            |
| Unitholders' Equity - 35,493,542 Fund units outstanding              | 299,351                 | 299,351                    |
| Accumulated earnings and distributions                               | 1,798                   | (9,861)                    |
| Accumulated other comprehensive income (note 6)                      | 65                      | -                          |
| <b>Total Unitholders' Equity</b>                                     | <b>301,214</b>          | <b>289,490</b>             |
|  | <b>\$ 306,183</b>       | <b>302,268</b>             |

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

Subsequent events (note 7)

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

Approved by the Trustees



Stan Bracken-Horrocks



Charles Jago

## **Canfor Pulp Income Fund**

### **Notes to the Interim Consolidated Financial Statements as at March 31, 2007.**

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

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

These unaudited interim consolidated financial statements include the accounts of the Fund and the Trust. From the date of its establishment on April 21, 2006 to June 30, 2006 the Fund was inactive. As a result there are no comparative figures in the unaudited interim consolidated financial statements for the first quarter of 2006.

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

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

#### **2. Significant Accounting Policies**

These unaudited interim consolidated financial statements do not include all of the disclosures required by Canadian generally accepted accounting principles for annual financial statements and, accordingly, should be read in conjunction with the audited consolidated financial statements and notes included in the Fund's 2006 Annual Report. These unaudited interim consolidated financial statements follow the same accounting policies and methods of computation as used in the 2006 consolidated financial statements, except as noted below.

##### *Adoption of New Pronouncements - Financial Instruments*

Effective January 1, 2007, the Fund adopted the Canadian Institute of Chartered Accountants' new Handbook Sections 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 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, 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 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 Fund has classified its distribution receivable as loans and receivables. Distributions payable are classified as other liabilities and 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.

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 net assets that result from transactions, events and circumstances from sources other than the Unitholders. For the period ended March 31, 2007, the Fund's other

comprehensive income resulted from its equity interest in the Partnership (see notes to the Partnership's unaudited interim consolidated financial statements).

### 3. Equity Investment in Canfor Pulp Limited Partnership

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

| (thousands of dollars, unaudited)   | 3 months ended<br>March 31, 2007 | 6 months ended<br>December 31, 2006 |
|---|----------------------------------|-------------------------------------|
| Balance, beginning of the 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   | 24,203                           | 20,558                              |
| Equity interest in other comprehensive income of the Partnership                                      | 980                              | -                                   |
| Distributions received and receivable   | (14,907)                         | (30,419)                            |
| <b>Balance, end of period</b>   | <b>301,214</b>                   | <b>289,490</b>                      |

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

### 4. Distributions

The Fund declared distributions during the first quarter of 2007 as follows:

| (thousands of dollars, except per unit amounts, unaudited) |                   | Amount per Fund Unit |              |       | Amount |
|--|-------------------|----------------------|--------------|-------|--------|
| Record Date  | Payable Date      | Monthly              | Supplemental | Total |        |
|  |                   | \$                   | \$           | \$    | \$     |
| January 31, 2007   | February 15, 2007 | 0.14                 | -            | 0.14  | 4,969  |
| February 28, 2007  | March 15, 2007    | 0.14                 | -            | 0.14  | 4,969  |
| March 30, 2007   | April 13, 2007    | 0.14                 | -            | 0.14  | 4,969  |
|  |                   | 0.42                 | -            | 0.42  | 14,907 |

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

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

### 5. Related Party Transactions

For the three months ended March 31, 2007, the Fund had incurred operating expenses with third parties of \$264,000 which were paid by the Partnership pursuant to the terms of the Partnership agreement.

### 6. Accumulated Other Comprehensive Income

| (thousands of dollars, unaudited)  | 3 months ended<br>March 31, 2007 |
|--|----------------------------------|
| Balance, beginning of period – January 1, 2007                                       | -                                |
| Accounting policy change - Accumulated other comprehensive income of the Partnership | (915)                            |
| Balance, beginning of period – January 1, 2007 as restated                           | (915)                            |
| Other comprehensive income   | 980                              |
| <b>Balance, end of period – March 31, 2007</b>                                       | <b>65</b>                        |

## **7. Subsequent Events**

On April 16, 2007 the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on May 15, 2007 to unitholders of record on April 30, 2007, based on a Partnership distribution to the Fund of \$5.0 million declared on April 16, 2007.

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

| (millions of dollars, unaudited)                              | <b>3 months ended<br/>March 31, 2007</b> |                   | 3 months ended<br>March 31, 2006 |            |
|---|--|-------------------|----------------------------------|------------|
| <b>Sales</b>  | \$                                       | <b>238.2</b>      | \$                               | 195.5      |
| <b>Costs and expenses</b>                                     |  |                   |                                  |            |
| Manufacturing and product costs                               |  | <b>143.2</b>      |                                  | 127.5      |
| Freight and other distribution costs                          |  | <b>28.5</b>       |                                  | 30.0       |
| Amortization  |  | <b>12.1</b>       |                                  | 12.5       |
| Selling and administration costs                              |  | <b>6.4</b>        |                                  | 5.8        |
|   |  | <b>190.2</b>      |                                  | 175.8      |
| <b>Operating income</b>                                       |  | <b>48.0</b>       |                                  | 19.7       |
| Interest expense, net   |  | <b>(1.8)</b>      |                                  | -          |
| Unrealized foreign exchange gain on long-term debt            |  | <b>1.4</b>        |                                  | -          |
| Unrealized gain on derivative instruments (note 11)           |  | <b>2.2</b>        |                                  | -          |
| Other income (expense)  |  | <b>(1.2)</b>      |                                  | 0.7        |
|   |  | <b>0.6</b>        |                                  | -          |
| <b>Net Income</b>   | \$                                       | <b>48.6</b>       | \$                               | 20.4       |
| Other comprehensive income                                    |  |                   |                                  |            |
| Adjustment for realized derivatives (note 14)                 |  | <b>2.0</b>        |                                  | -          |
| <b>Comprehensive Income</b>                                   |  | <b>50.6</b>       |                                  | 20.4       |
| <b>Net income per Partnership unit</b> (in dollars) (note 10) |  |                   |                                  |            |
| Basic and diluted   | \$                                       | <b>0.68</b>       | \$                               | 0.29       |
| <b>Weighted average Partnership units outstanding</b>         |  | <b>71,270,025</b> |                                  | 71,270,025 |
| <b>Partners' Equity</b>                                       |  |                   |                                  |            |
| Balance, beginning of period                                  | \$                                       | <b>581.0</b>      | \$                               | 728.7      |
| Accounting policy change (note 3)                             |  | <b>4.7</b>        |                                  | -          |
| Balance, beginning of period as restated                      |  | <b>585.7</b>      |                                  | 728.7      |
| Net transactions with Canfor                                  |  | <b>-</b>          |                                  | (31.9)     |
| Net Income  |  | <b>48.6</b>       |                                  | 20.4       |
| Distributions to partners (note 13)                           |  | <b>(30.2)</b>     |                                  | -          |
| Accumulated other comprehensive income (note 14)              |  | <b>0.2</b>        |                                  | -          |
| <b>Balance, end of period</b>                                 | \$                                       | <b>604.3</b>      | \$                               | 717.2      |

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

**Canfor Pulp Limited Partnership**  
**Consolidated Statements of Cash Flows**

| (millions of dollars, unaudited)                          | <b>3 months ended<br/>March 31, 2007</b> | 3 months ended<br>March 31, 2006 |
|---|--|----------------------------------|
| <b>Cash and cash equivalents generated from (used in)</b> |  |                                  |
| <b>Operating activities</b>                               |  |                                  |
| Net income  | \$ 48.6                                  | \$ 20.4                          |
| Items not affecting cash:                                 |  |                                  |
| Amortization  | 12.1                                     | 12.5                             |
| Unrealized foreign exchange gain on long-term debt        | (1.4)                                    | -                                |
| Unrealized gain on derivative instruments                 | (2.2)                                    | -                                |
| Employee future benefits                                  | 1.7                                      | -                                |
| Other   | (0.3)                                    | -                                |
| Cash flow from operations before working capital changes  | 58.5                                     | 32.9                             |
| Changes in non-cash working capital (note 12)             | (6.6)                                    | 2.8                              |
|   | <b>51.9</b>                              | <b>35.7</b>                      |
| <b>Financing activities</b>                               |  |                                  |
| Net transactions with Canfor                              | -  | (31.9)                           |
|   | -  | (31.9)                           |
| <b>Investing activities</b>                               |  |                                  |
| Property, plant and equipment, net                        | (3.2)                                    | (4.0)                            |
| Distributions paid to partners                            | (45.6)                                   | -                                |
| Salary pension plan contribution                          | (3.4)                                    | -                                |
|   | <b>(52.2)</b>                            | <b>(4.0)</b>                     |
| <b>Decrease in cash and cash equivalents</b>              | <b>(0.3)</b>                             | <b>(0.2)</b>                     |
| <b>Cash and cash equivalents, beginning of period</b>     | <b>28.4</b>                              | <b>0.6</b>                       |
| <b>Cash and cash equivalents, end of period</b>           | <b>\$ 28.1</b>                           | <b>\$ 0.4</b>                    |

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

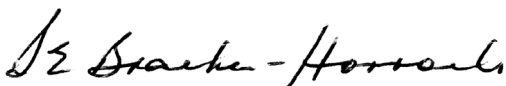
**Canfor Pulp Limited Partnership  
Consolidated Balance Sheets**

| (millions of dollars, unaudited)  | As at<br>March 31, 2007 | As at<br>December 31, 2006 |
|---|-------------------------|----------------------------|
| <b>ASSETS</b>   |                         |                            |
| <b>Current assets</b>   |                         |                            |
| Cash and cash equivalents   | \$ 28.1                 | \$ 28.4                    |
| Accounts receivable (note 9)  |                         |                            |
| Trade   | 165.3                   | 130.9                      |
| Other   | 9.3                     | 6.7                        |
| Inventories (note 6)  | 118.8                   | 111.0                      |
| Prepaid expenses  | 16.9                    | 13.1                       |
| <b>Total current assets</b>   | <b>338.4</b>            | 290.1                      |
| <b>Property, plant and equipment</b> (note 8)   | <b>589.6</b>            | 598.6                      |
| <b>Deferred charges and other assets</b> (note 7)   | <b>14.2</b>             | 4.7                        |
|   | <b>\$ 942.2</b>         | \$ 893.4                   |
| <b>LIABILITIES</b>  |                         |                            |
| <b>Current liabilities</b>  |                         |                            |
| Accounts payable and accrued liabilities (note 9)   | \$ 166.4                | \$ 125.5                   |
| Distributions payable (note 13)   | 10.0                    | 25.8                       |
| <b>Total current liabilities</b>  | <b>176.4</b>            | 151.3                      |
| <b>Long-term debt</b> (note 4)  | <b>126.8</b>            | 128.2                      |
| <b>Long-term liabilities</b> (note 5)   | <b>34.7</b>             | 32.9                       |
|   | <b>\$ 337.9</b>         | \$ 312.4                   |
| <b>PARTNERS' EQUITY</b> – 14,254,005 Class A Limited Partnership Units and<br>57,016,020 Class B Limited Partnership Units (note 1) | <b>604.3</b>            | 581.0                      |
|   | <b>\$ 942.2</b>         | \$ 893.4                   |

Subsequent event (note 16)

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

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



Stan Bracken-Horrocks  
Director



Paul Richards  
Director

## **Canfor Pulp Limited Partnership**

### **Notes to the Interim Consolidated Financial Statements as at March 31, 2007**

#### **1. Business Description and Basis of Presentation**

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

At March 31, 2007, Canfor owns 50.2% and Canfor Pulp Income Fund (the Fund) indirectly owns 49.8% of the issued and outstanding units of the Partnership.

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

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

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

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

#### *Economic Dependence*

The Partnership depends on Canfor to provide approximately 64% of its fibre supply as well as to provide certain key business and administrative services as described in the Fund's 2006 Annual Report. As a result of these relationships the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

#### **2. Significant Accounting Policies**

These unaudited interim consolidated financial statements do not include all of the note disclosures required by Canadian generally accepted accounting principles for annual financial statements. Except as described in note 3, the Partnership's accounting policies are as disclosed in the annual audited consolidated financial statements included in the Fund's 2006 Annual Report available at [www.canforpulp.com](http://www.canforpulp.com) or [www.sedar.com](http://www.sedar.com).

### 3. Changes in Accounting Policies

The accounting policy changes impacting opening Partners' equity are comprised of the following:

(millions of dollars, unaudited)

|                               |       |
|-------------------------------|-------|
| Defined benefit pension plans | 6.3   |
| Deferred financing costs      | (1.6) |
|                               | 4.7   |

The aggregate adjustment resulting from the change in accounting policy and the adoption of new accounting pronouncements was an increase of \$4.7 million to opening Partners' equity.

#### *Change in Accounting Policy - Employee Future Benefits*

During the quarter ended March 31, 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. Consequently, the Partnership has 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 policy is included below and details are provided in note 7.

#### *Employee Future Benefits*

The Partnership accrues the costs and related obligations of the defined benefit pension plan using the projected benefit actuarial method pro-rated on service and management's best estimates of salary escalation and other relevant factors. Actuarial gains (losses) arise from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees, which is 8 years. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. January 1, 2000, the Pulp Business (Canfor) adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to the accounting for pensions and other post employment benefits using the prospective application method. The Partnership is amortizing the transitional obligation on a straight-line basis over 13 years, which was the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

#### *Financial Instruments*

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

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

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

As a result of consideration of the new guidance provided in Section 3865 – “Hedges”, on a prospective basis, the Partnership has determined not to utilize hedge accounting on its existing derivative instruments. As a result, these instruments, which were previously recorded using hedge accounting, were measured at fair value on January 1, 2007 with a corresponding adjustment through accumulated other comprehensive income (see note 14).

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 net assets that result 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 Partners’ equity at January 1, 2007.

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

#### 4. Credit Facilities and Long-term Debt

The Partnership has outstanding long-term debt of \$126.8 million (US\$110.0 million) in the form of unsecured U.S. dollar private placement notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013.

The fair value of long-term debt at March 31, 2007 was \$ 127.4 million (US\$110.5 million).

#### 5. Long-term Liabilities

| (millions of dollars, unaudited)  | March 31, 2007 | December 31, 2006 |
|-----------------------------------|----------------|-------------------|
| Accrued pension obligations       | 3.1            | 2.7               |
| Post employment benefits (note 7) | 31.6           | 30.2              |
|                                   | <b>34.7</b>    | 32.9              |

#### 6. Inventories

| (millions of dollars, unaudited)  | March 31, 2007 | December 31, 2006 |
|-----------------------------------|----------------|-------------------|
| Pulp                              | 52.0           | 48.9              |
| Paper                             | 12.3           | 11.6              |
| Wood chips                        | 8.1            | 5.4               |
| Processing materials and supplies | 46.4           | 45.1              |
|                                   | <b>118.8</b>   | 111.0             |

## 7. Employee Future Benefits

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

Total employee future benefit expenses were as follows:

| (millions of dollars, unaudited)             | <b>3 months ended<br/>March 31, 2007</b> | 3 months ended<br>March 31, 2006 |
|--|--|----------------------------------|
| Pension plans                                | 1.2                                      | 1.2                              |
| Other employee future benefit plans          | 1.5                                      | 1.8                              |
| Contributions to forest industry union plans | 1.6                                      | 1.6                              |
|  | <b>4.3</b>                               | 4.6                              |

### *Defined Benefit Plans*

The measurement date for the accrued benefit obligations and fair value of assets for accounting purposes is at September 30, 2006. The most recent actuarial valuation for the Canfor salaried employees pension plans, in which the Partnership's employees participate, was on December 31, 2005.

Information about the Partnership's participation in the Canfor salaried employees pension plans is as follows:

#### **Defined Benefit Plan Obligations – Salaried Pension Plans**

| (millions of dollars, unaudited)      | <b>March 31, 2007</b> |
|---------------------------------------|-----------------------|
| Accrued benefit obligation            |                       |
| Beginning of period – January 1, 2007 | <b>50.3</b>           |
| Current service cost                  | <b>0.8</b>            |
| Interest cost                         | <b>0.7</b>            |
| Employee contributions                | <b>0.1</b>            |
| Benefit payments                      | -                     |
| Actuarial loss (gain)                 | -                     |
| End of period – March 31, 2007        | <b>51.9</b>           |

#### **Defined Benefit Plan Assets – Salaried Pension Plans**

| (millions of dollars, unaudited)      | <b>March 31, 2007</b> |
|---------------------------------------|-----------------------|
| Fair value of plan assets             |                       |
| Beginning of period – January 1, 2007 | <b>46.4</b>           |
| Actual return on plan assets          | <b>0.8</b>            |
| Employer contributions                | <b>5.7</b>            |
| Employee contributions                | <b>0.1</b>            |
| Benefits paid                         | -                     |
| End of period – March 31, 2007        | <b>53.0</b>           |

**Reconciliation of the Funded Status of the Benefit Plans  
To the Amounts Recorded in the Financial Statements – Salaried Pension Plans**

| (millions of dollars, unaudited)              | <b>March 31, 2007</b> |
|---|-----------------------|
| Fair market value of plan assets              | <b>53.0</b>           |
| Accrued benefit obligation                    | <b>51.9</b>           |
| Funded status of plans – surplus              | <b>1.1</b>            |
| Employer contributions after measurement date | -                     |
| Unamortized transitional obligation (asset)   | <b>(2.5)</b>          |
| Unamortized past service costs                | <b>0.2</b>            |
| Unamortized net actuarial loss                | <b>11.7</b>           |
| Accrued benefit asset                         | <b>10.5</b>           |

The accrued benefit asset of \$10.5 million is included in deferred charges and other assets on the balance sheet.

The Partnership's expense for participation in Canfor's salaried pension plans is as follows:

| (millions of dollars, unaudited)                    | <b>3 months ended<br/>March 31, 2007</b> |
|---|--|
| <b>Defined Pension Benefit Plans</b>                |  |
| Current service cost, net of employee contributions | <b>0.8</b>                               |
| Interest cost                                       | <b>0.7</b>                               |
| Return on plan assets                               | <b>(0.8)</b>                             |
| Actuarial loss                                      | <b>0.2</b>                               |
| Amortization of transitional obligation             | <b>(0.1)</b>                             |
|   | <b>0.8</b>                               |

*Significant Assumptions*

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

| (weighted average assumptions)                   |              |
|--|--------------|
| Accrued benefit obligation:                      |              |
| Discount rate                                    | <b>5.25%</b> |
| Rate of compensation increase                    | <b>3.0%</b>  |
| Benefit costs:                                   |              |
| Discount rate                                    | <b>5.25%</b> |
| Expected long-term rate of return on plan assets | <b>7.0%</b>  |
| Rate of compensation increase                    | <b>3.0%</b>  |

## 8. Property Plant and Equipment

| (millions of dollars, unaudited)   | March 31, 2007 |                             |              |
|------------------------------------|----------------|-----------------------------|--------------|
|                                    | Cost           | Accumulated<br>amortization | Net          |
| Land                               | 5.4            | -                           | 5.4          |
| Buildings, machinery and equipment | 1,273.9        | 696.4                       | 577.5        |
| Construction in progress           | 6.7            | -                           | 6.7          |
|                                    | <b>1,286.0</b> | <b>696.4</b>                | <b>589.6</b> |

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

## 9. Related Party Transactions

The Partnership's transactions with related parties are consistent with the transactions described in the December 31, 2006 consolidated financial statements and are based on agreed upon amounts, and are summarized below:

| (millions of dollars, unaudited)   | 3 months ended March<br>31, 2007 | 3 months ended<br>March 31, 2006 |
|--|----------------------------------|----------------------------------|
| <b>Transactions</b>  |                                  |                                  |
| Canfor   | 35.1                             | 20.3                             |
| Howe Sound LP - commission   | 0.8                              | 1.4                              |
| Lakeland Mills Ltd. and Winton Global Lumber Ltd. – purchase of wood chips | 3.4                              | 1.8                              |
| <b>Balance Sheet</b>   |                                  |                                  |
| Included in accounts payable and accrued liabilities:                      |                                  |                                  |
| Canfor   | 31.0                             | 10.7                             |
| Howe Sound LP  | 41.4                             | 37.1                             |
| Lakeland Mills Ltd. and Winton Global Lumber Ltd.                          | 1.2                              | 0.5                              |
| Included in trade accounts receivable:                                     |                                  |                                  |
| Canfor   | 14.0                             | 10.0                             |
| Howe Sound LP  | 40.9                             | 33.1                             |

Transactions and payables to Canfor include purchases of wood chips, pulp and administrative services.

## 10. Income per Partnership Unit

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

## 11. Financial Instruments

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

The net unrealized gain recorded in the quarter ended March 31, 2007 relating to derivative instruments totaled \$2.2 million. This relates to outstanding commodity swaps hedging future natural gas purchases of 2.8 million giga-joules extending to March 2010.

## 12. Changes in Non-Cash Working Capital

| (millions of dollars, unaudited)         | <b>3 months ended<br/>March 31, 2007</b> | 3 months ended<br>March 31, 2006 |
|--|--|----------------------------------|
| Accounts receivable                      | <b>(35.9)</b>                            | (0.2)                            |
| Inventories                              | <b>(7.8)</b>                             | (4.5)                            |
| Prepaid expenses                         | <b>(3.8)</b>                             | 4.9                              |
| Accounts payable and accrued liabilities | <b>40.9</b>                              | 2.6                              |
|  | <b>(6.6)</b>                             | 2.8                              |

## 13. Distributions

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

| (millions of dollars, except per unit amounts, unaudited) |                     | <b>Amount per Partnership Unit</b> |                     |              | <b>Amount</b> |
|---|---------------------|------------------------------------|---------------------|--------------|---------------|
| <b>Record Date</b>  | <b>Payable Date</b> | <b>Monthly</b>                     | <b>Supplemental</b> | <b>Total</b> |               |
|   |                     | <b>\$</b>                          | <b>\$</b>           | <b>\$</b>    | <b>\$</b>     |
| January 31, 2007  | February 15, 2007   | 0.14                               | -                   | 0.14         | <b>10.0</b>   |
| February 28, 2007   | March 15, 2007      | 0.14                               | -                   | 0.14         | <b>9.9</b>    |
| March 30, 2007  | April 15, 2007      | 0.14                               | -                   | 0.14         | <b>10.0</b>   |
| Distribution to cover Fund expenses                       |                     |                                    |                     |              | <b>0.3</b>    |
|   |                     | 0.42                               |                     | 0.42         | <b>30.2</b>   |

## 14. Accumulated Other Comprehensive Income

| (millions of dollars, unaudited)   | <b>3 months ended<br/>March 31, 2007</b> |
|--|--|
| Balance, beginning of period – January 1, 2007                             | -  |
| Accounting policy change for derivative instruments:                       |  |
| Unrealized loss on natural gas swaps                                       | <b>(0.8)</b>                             |
| Unrealized loss on pulp swaps  | <b>(1.0)</b>                             |
| Balance, beginning of period – January 1, 2007, as restated                | <b>(1.8)</b>                             |
| Adjustment for realized derivatives recorded in other comprehensive income | <b>2.0</b>                               |
| Balance, end of period – March 31, 2007                                    | <b>0.2</b>                               |

## 15. Segmented Information <sup>(a)</sup>

| (millions of dollars, unaudited)              | Pulp  | Paper  | Unallocated<br>Costs <sup>(d)</sup> | Total |
|---|-------|--------|-------------------------------------|-------|
| <b>3 months ended March 31, 2007</b>          |       |        |                                     |       |
| Sales to external customers <sup>(b)</sup>    | 207.7 | 30.5   | -                                   | 238.2 |
| Sales of pulp to paper segment <sup>(c)</sup> | 20.0  | (20.0) | -                                   | -     |
| Operating income (loss)                       | 52.8  | 0.1    | (4.9)                               | 48.0  |
| Amortization                                  | 11.0  | 1.0    | 0.1                                 | 12.1  |
| Capital expenditures, net                     | 2.8   | 0.4    | -                                   | 3.2   |
| Identifiable assets                           | 820.3 | 71.1   | 50.8                                | 942.2 |
| <b>3 months ended March 31, 2006</b>          |       |        |                                     |       |
| Sales to external customers <sup>(b)</sup>    | 167.4 | 28.1   | -                                   | 195.5 |
| Sales of pulp to paper segment <sup>(c)</sup> | 16.5  | (16.5) | -                                   | -     |
| Operating income (loss)                       | 22.0  | 1.5    | (3.8)                               | 19.7  |
| Amortization                                  | 11.4  | 1.0    | 0.1                                 | 12.5  |
| Capital expenditures, net                     | 3.8   | -      | 0.2                                 | 4.0   |
| Identifiable assets                           | 793.6 | 73.8   | 2.0                                 | 869.4 |

- (a) Operations are presented by product lines. Operations are considered to be in one geographic area since all production facilities are in Canada. Substantially all sales are exported outside Canada, with sales to the United States representing 43% (2006 – 44%).
- (b) Sales to two largest customers represented approximately 36% of pulp segment sales (2006 – 30%).
- (c) Sales of slush pulp to the paper segment are accounted for at approximate market value. The sales are transacted as a cost transfer and are not reflected in Pulp sales.
- (d) Unallocated costs represent actual head office administrative costs in the first quarter of 2007. For the first quarter of 2006, head office administrative costs were based on allocated Canfor corporate expenses as described in Note 1.

## 16. Subsequent Event

On April 16, 2007 the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on May 15, 2007 to unitholders of record on April 30, 2007.