CANFOR PULP INCOME FUND

CANFOR PULP LIMITED PARTNERSHIP

Management's Discussion and Analysis

For the year ended December 31, 2009

Canfor Pulp Income Fund and Canfor Pulp Limited Partnership
2009 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. 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, 2009 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 February 18, 2010, 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.

The information in this report is as at February 5, 2010.

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 the Partnership, its prospects and uncertainties relating to the Fund, the 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 the 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 the 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:
- *"Critical Accounting Estimates" on page 6;*
- *"SIFT Conversion Rules" on page 7;*
- *"Conversion to International Financial Reporting Standards" on page 7;*
- *"Outlook – Pulp" on page 12;*
- *"Outlook – Kraft Paper" on page 13;*
- *"Financial Requirements and Liquidity" on page 15;*
- *"Capital Requirements" on page 20;*
- *"Critical Accounting Estimates" on page 21 and 22;*
- *"Conversion to International Financial Reporting Standards" on pages 23 to 25;*
- *"Distributable Cash and Cash Distributions" on page 26 and 27.*

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 the Partnership. Additional information concerning these and other factors can be found in the Fund's AIF dated February 18, 2010, which is available on www.sedar.com.

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 5, 2010, there were a total of 35,493,505 Fund units issued and outstanding, and the Fund indirectly held a total of 35,493,542 units of the Partnership, representing 49.8% of the Partnership. Canadian Forest Products Ltd. (Canfor) held 35,776,483 Class B Exchangeable Limited Partnership Units, representing 50.2% of the Partnership. The Class B Exchangeable Limited Partnership Units are indirectly exchangeable for an equivalent number of Fund Units pursuant to the terms of an exchange agreement (Exchange Agreement) dated July 1, 2006 among Canfor, the Fund, the Trust, the Partnership and the General Partner. The Exchange Agreement contains, among other things, the procedure through which the Class B Exchangeable Limited Partnership Units may be exchanged for Fund Units.

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.

2009 HIGHLIGHTS

- Distributions totalled $9.2 million or $0.26 per Fund unit in 2009.
- Net income of $9.1 million.

EQUITY INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

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

(thousands of dollars)	**Year ended December 31, 2009**	Year ended December 31, 2008
Balance, beginning of year	**266,274**	291,458
Equity income of the Partnership	**6,644**	23,280
Equity interest in other comprehensive loss of the Partnership	**(45)**	(193)
Distributions from the Partnership	**(9,229)**	(48,271)
Balance, end of year	**263,644**	266,274

The Fund's investment in the Partnership units is recorded using the equity method.

SELECTED ANNUAL FUND FINANCIAL INFORMATION

(thousands of dollars, except per unit amounts, unaudited)	**Year ended December 31, 2009**	Year ended December 31, 2008	Year ended December 31, 2007
Equity income of the Partnership	**6,644**	23,280	64,643
Net income[1]	**9,066**	20,204	28,010
Net income per Fund unit	**$0.26**	$0.57	$0.79
Distributions earned from the Partnership and declared to unitholders	**9,229**	48,271	65,308
Distributions declared per unit	**$0.26**	$1.36	$1.84
Partnership adjusted distributable cash per unit[2]	**$0.43**	$1.35	$1.93

Notes: [1] In 2009 the Fund recorded a non-cash future income tax recovery of $2.4 million compared to a non-cash future income expense of $3.1 million in 2008 and $36.6 million in 2007, 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.

[2] Represents the Partnership's adjusted distributable cash for which the Fund is dependent on to make its own distributions. For further details on the Partnership's adjusted distributable cash see the Partnership's disclosure on pages 26 and 27.

2009 COMPARED TO 2008

For the year ended December 31, 2009, the Fund had net income of $9.1 million, or $0.26 per unit compared to net income of $20.2 million, or $0.57 per unit for the year ended December 31, 2008. These results represent the Fund's share of the Partnership's earnings for the year, including a future income tax recovery of $2.4 million for the year ended December 31, 2009 (2008, future income tax expense — $3.1 million). The Fund's earnings were lower than those in the prior year due to the Fund's share of lower operating earnings, partially offset by a reduction in charges for non-operating items included in the equity income of the Partnership. The Fund's share of lower operating earnings were primarily attributable to lower realized prices in Canadian dollar terms for the Partnership's products, partially offset by higher sales volumes and lower unit manufacturing and freight costs. The Fund's share of non-operating items included in equity income of the Partnership for 2009 totalled $0.7 million, and was primarily the result of a foreign exchange gain on translation of US dollar denominated long-term debt, partially offset by interest expense, loss on derivative financial instruments and a foreign exchange loss on working capital. Distributions declared by the Partnership and accruing to the Fund were $9.2 million, or $0.26 per Fund unit of which $2.8 million was receivable at December 31, 2009 as compared to $48.3 million, or $1.36 per Fund unit of which $1.4 million was receivable at December 31, 2008.

2009 COMPARED TO 2007

For the year ended December 31, 2009, the Fund had net income of $9.1 million, or $0.26 per unit compared to net income of $28.0 million, or $0.79 per unit for the year ended December 31, 2007. These results represent the Fund's share of the Partnership's earnings for the year, including a future income tax recovery of $2.4 million for the year ended December 31, 2009 (2007, future income tax expense — $36.6 million). The Fund's earnings were lower than those in 2007 primarily due to the Fund's share of lower operating earnings. The Partnership's lower operating earnings were primarily attributable to lower realized prices in Canadian dollar terms for the Partnership's products. Distributions declared by the Partnership and accruing to the Fund were $9.2 million, or $0.26 per Fund unit of which $2.8 million was receivable at December 31, 2009 as compared to $65.3 million, or $1.84 per Fund unit of which $4.3 million was receivable at December 31, 2007.

SELECTED QUARTERLY FUND FINANCIAL INFORMATION

(thousands of dollars, except per unit amounts, unaudited)	**Q4 2009**	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Equity income (loss) in the Partnership	**7,562**	9,098	724	(10,740)	(12,947)	5,513	9,046	21,667
Net income (loss)	**6,903**	8,497	4,406	(10,740)	(13,686)	5,208	7,015	21,667
Net income (loss) per Fund unit	**$0.20**	$0.24	$0.12	$(0.30)	$(0.39)	$0.15	$0.20	$0.61
Distributions earned from the Partnership and declared to unitholders	**4,969**	1,065	1,065	2,130	9,938	12,778	12,777	12,778
Distributions declared per Fund unit	**$0.14**	$0.03	$0.03	$0.06	$0.28	$0.36	$0.36	$0.36
Partnership adjusted distributable cash per unit[1]	**$0.31**	$0.16	$0.02	$(0.06)	$0.02	$0.54	$0.19	$0.60

Note: [1] Represents the Partnership's adjusted distributable cash for which the Fund is dependent on to make its own distributions. For further details on the Partnership's adjusted distributable cash see the Partnership's disclosure on pages 26 and 27.

FOURTH QUARTER 2009 RESULTS

For the quarter ended December 31, 2009, the Fund had net income of $6.9 million or $0.20 per unit. The net income is the Fund's share of the Partnership's income for the fourth quarter of 2009, less a future income tax expense of $0.7 million. The Fund's share of non-operating items included in equity income of the Partnership for the fourth quarter of 2009 was $0.4 million, and was primarily the result of a foreign exchange gain on translation of US dollar denominated long-term debt and a gain on derivative financial instruments, partially offset by a foreign exchange loss on working capital. Distributions declared by the Partnership and accruing to the Fund were $5.0 million of which $2.8 million was receivable at December 31, 2009. 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 payable by the Partnership to the Fund and distributions payable by the Fund to its unitholders are recorded when declared. During 2009, the Fund declared distributions of \$0.26 per Fund unit or \$9.2 million.

Monthly cash distributions from the Partnership are not directly equal to the Fund's pro-rata share of the Partnership's income (loss) under the equity method. This is primarily due to capital expenditures, foreign exchange gains or losses on translation of US dollar denominated debt, changes in value of derivative instruments, amortization, and other non-cash expenses of the Partnership.

FUND UNITS

At February 5, 2010, there were a total of 35,493,505 Fund 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 the majority of 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 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 and its capital expenditure requirements. Accordingly, there is no assurance that distributions will be maintained at current levels. The market value of the Fund units may deteriorate if the Fund is unable to maintain its distribution levels in the future.

Income Taxes

The Fund is a unit trust for income tax purposes. As such, the Fund only has current tax expense on any taxable income not allocated to the unitholders. For the years ended December 31, 2009 and December 31, 2008, all taxable income of the Fund was allocated to the unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the unitholders.

Future Income Taxes

Future income tax assets and liabilities are determined based on the difference between the tax basis of the Fund's and 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.

RELATED PARTY TRANSACTIONS

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf, without charge, by the Partnership pursuant to a support agreement. Distributions earned from the Partnership for the year ended December 31, 2009 were $9.2 million of which $6.4 million was received, with the balance of $2.8 million receivable on December 31, 2009. Distributions earned from the Partnership for the year ended December 31, 2008 were $48.3 million of which $46.9 million was received, with the balance of $1.4 million receivable on December 31, 2008.

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. Significant areas requiring the use of management's estimates are the determination of future income taxes, and assessing whether there has been an other than temporary decline in the value of the investment in the Partnership. The determination of the future income tax liability requires management to estimate the future impacts of the Partnership's amortization of capital assets, capital cost allowance claims for tax purposes, and changes to actuarial estimates of employee benefit plans. The Fund accounts for its investment in the Partnership using the equity method. The Fund analyzes the carrying value of its investment in the Partnership by considering the underlying value of the Partnership's business. This assessment includes various long-term assumptions related to the Partnership's operations which may not be reflected in the current market value of the Fund. Changes in these estimates could have a material impact on the calculation of the future income tax liability or equity investment in the Partnership.

CHANGES IN ACCOUNTING POLICIES

Financial Instrument Disclosures

In June 2009, the Canadian Institute of Chartered Accountants (CICA) amended Handbook Section 3862, Financial Instruments – Disclosures, to enhance disclosures about fair value measurements and the liquidity risk of financial instruments. These amendments are intended to provide further detail on the relative reliability of the data or inputs used to measure the fair value of the entities financial instruments. Specifically, financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The Fund has incorporated this amendment into the audited consolidated financial statements.

SIFT CONVERSION RULES

On June 12, 2007, legislation was substantively enacted whereby distributions made by publicly traded income trusts and partnerships will be taxed similar to that of income earned and distributed by a corporation. The Specified Investment Flow-Through Trust (SIFT) Tax will become effective on January 1, 2011. On March 12, 2009 the Canadian government enacted legislation (SIFT Conversion Rules) which enables the conversion of a SIFT into a corporation on a tax-free rollover basis, prior to 2013. The Fund has reviewed its options and intends to present a proposal for unitholders' approval at the annual general meeting on April 27, 2010 involving an internal restructuring under which unitholders will hold their beneficial interest in the Partnership through a corporation rather than a trust.

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

On February 13, 2008, the Accounting Standards Board (AcSB) announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The Fund will rely on the resources of the Partnership to ensure compliance with IFRS. The Partnership intends to convert to these new standards according to the timetable set for these new rules.

A detailed analysis was substantively completed and a number of areas were identified for further consideration before the date of transition. Various accounting policy choices have been identified to date and are being considered by the steering committee of the Partnership. The Partnership continues to monitor standards development as issued by the International Accounting Standards Board (IASB) and the AcSB, as well as regulatory developments as issued by the Canadian Securities Administrators, which may affect the timing, nature, or disclosure of the Partnership's adoption of IFRS. The IASB has issued several exposure drafts for new or amended IFRS, which will likely have mandatory application for the 2011 calendar year.

The Partnership will continue to review all proposed and continuing projects of the IASB to determine their impact on the Fund, and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

The impact on the Fund's future financial position and results of operations is primarily dependent on changes in accounting policies that may materially impact the Partnership's consolidated financial statements.

For further details on the key elements of the Partnership's transition plan see the Partnership's disclosure on pages 23 to 25.

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.

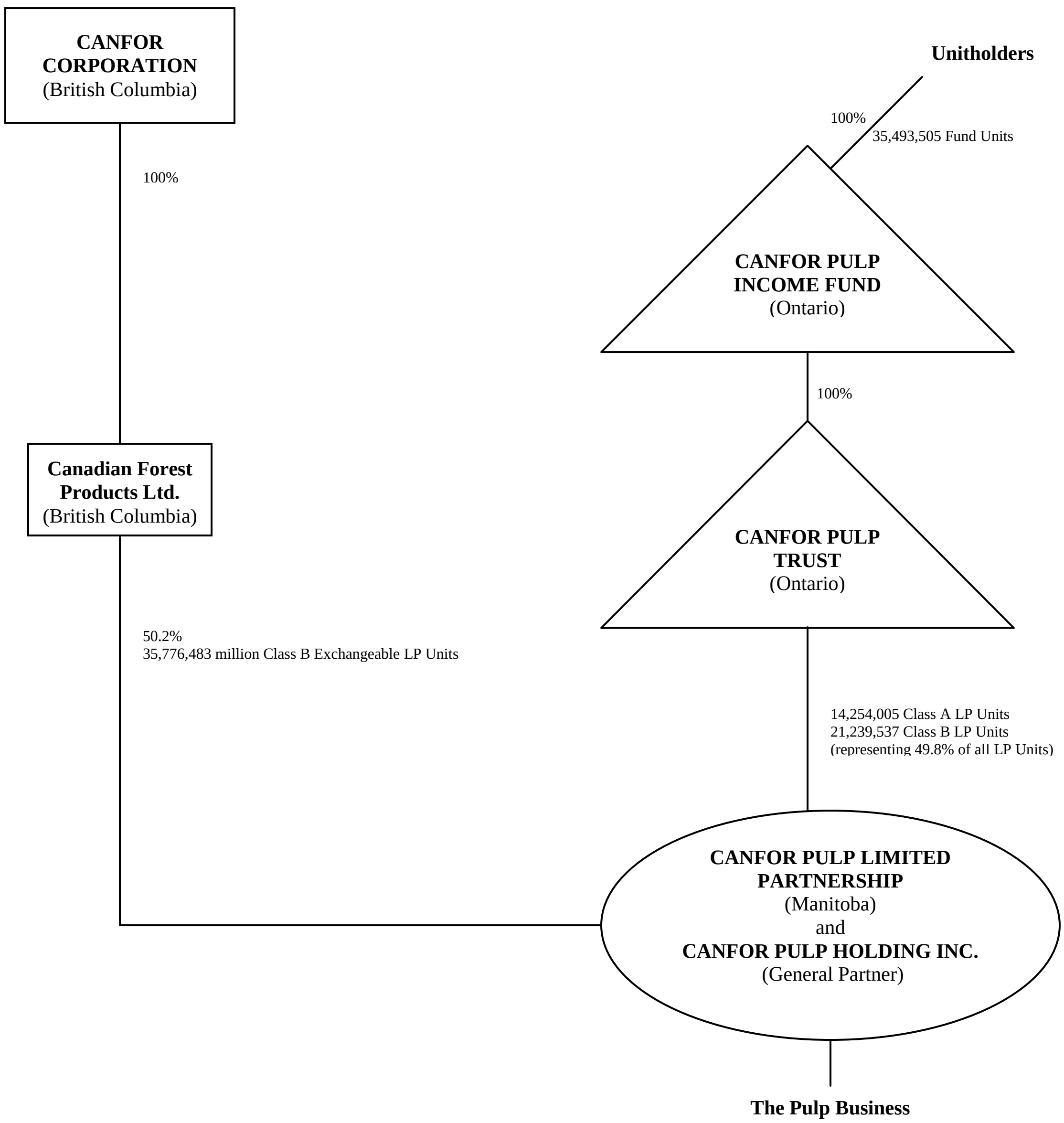
CANFOR PULP LIMITED PARTNERSHIP

Structure

The Partnership is a limited partnership formed on April 21, 2006, under the laws of Manitoba to acquire and carry on the Northern Bleached Softwood Kraft (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 5, 2010, the Fund indirectly held 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



The 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.

2009 HIGHLIGHTS

- Achieved record production of 313,565 tonnes at the Intercontinental Pulp Mill.
- Generated EBITDA of $61.8 million and distributed $18.6 million or $0.26 per Partnership unit to partners while managing through the global financial crisis.
- Received Green Transformation Program credits from the Canadian Federal Government totalling $122 million for reimbursement of funds to be spent by March 31, 2012 on qualifying energy and environmental capital projects.
- Focused on cash management and cost reduction initiatives through the global financial crisis resulting in a decrease of cash used in working capital totalling $31.8 million and reduction in unit manufacturing costs of 10%.
- Completed amending agreement with BC Hydro for sale of power.
- Completed new bank credit facility through November 2011.

Selected Annual Information

(millions of dollars except volumes and per unit amounts, unaudited)	**2009**	2008	2007
Sales volume - major products			
Pulp - thousands of metric tonnes	**1,044.6**	905.4	1,023.6
Paper - thousands of metric tonnes	**135.0**	124.8	129.5
Sales by segment			
Pulp	**690.0**	695.2	796.7
Paper	**122.5**	130.3	124.9
Unallocated	**1.0**	-	-
Total sales	**813.5**	825.5	921.6
Operating income (loss)			
Pulp	**11.7**	72.5	152.6
Paper	**10.6**	9.4	(2.1)
Unallocated costs	**(10.3)**	(13.2)	(16.2)
Total operating income	**12.0**	68.7	134.3
EBITDA (loss)			
Pulp	**57.9**	116.7	202.5
Paper	**13.9**	13.1	2.0
Unallocated costs	**(10.0)**	(12.9)	(16.0)
Total EBITDA	**61.8**	116.9	188.5
Net income	**13.4**	46.8	129.8
Net income per Partnership unit, basic and diluted	**$ 0.19**	$ 0.66	$ 1.82
Total assets	**837.6**	868.9	909.0
Total long-term debt	**115.1**	134.7	108.7
Adjusted distributable cash	**30.5**	96.1	137.7
Distributions declared	**18.6**	96.9	131.1
Distributions declared per unit	**$ 0.26**	$ 1.36	$ 1.84
Average exchange rate (US$/Cdn$)[1]	**0.876**	0.938	0.930

Note: [1] Source – Bank of Canada (average noon rate for the year)

2009 Compared to 2008

Net income and EBITDA for 2009 decreased by $33.4 million and by $55.1 million respectively over 2008. The focus in 2009 was on managing cash resources and cost reduction initiatives to mitigate the impact of weak markets for the Partnership's pulp and paper products in the first half of the year, precipitated by the global financial crisis. The decline in 2009 results was attributable to lower realized prices in Canadian dollar terms for the Partnership's products, partially offset by higher sales volumes and lower unit manufacturing and freight costs. Realized pulp prices in Canadian dollar terms were 14% lower when compared to 2008 as a 16% decrease in NBSK pulp US dollar list prices and a higher percentage of sales into lower margin business, were partially offset by the weaker Canadian dollar. Unit manufacturing costs decreased 10% when compared to 2008 due to the impact of higher production volumes, lower fibre, chemical and energy costs, and the impact of cost reduction initiatives. Sales volumes of NBSK market pulp and kraft papers increased by 139,200 and 10,200 tonnes respectively when compared to the prior year. The increased shipments of market pulp were attributable to higher production volumes in 2009 and increased demand from Asia. The lower freight costs were attributable to a reduction in fuel surcharges and lower container rates. Non-operating income, included in net income of the Partnership in 2009 totalled $1.4 million, an improvement of $23.3 million over 2008. The increase in non-operating income is primarily the result of a foreign exchange gain on translation of US dollar denominated long-term debt, reduction in losses on financial derivative instruments, partially offset by a foreign exchange loss on working capital.

2009 Compared to 2007

Net income and EBITDA for 2009 deteriorated by $116.4 million and $126.7 million respectively when compared to 2007. The lower earnings in 2009 were largely caused by lower realized prices in Canadian dollar terms for the Partnership's pulp and paper products and higher freight costs, partially offset by higher sales volumes. Realized pulp prices in Canadian dollar terms declined by 15% from 2007, as a 13% decrease in NBSK pulp US dollar list prices and a higher percentage of sales into lower margin business, were partially offset by the weaker Canadian dollar. Realized paper prices in Canadian dollar terms decreased by 6% when compared to 2007. Sales volumes for NBSK market pulp in 2009 were 21,000 tonnes or 2% higher than 2007. Unit manufacturing costs remained unchanged from 2007 as cost reduction initiative savings and lower fibre costs in 2009 were offset by the impact of lower production volumes, higher chemical prices and general inflation. Fibre costs decreased by approximately 4% when compared to 2007 due to lower prices for residual and whole log chips, partially offset by an increase in the volume of higher cost whole log chips. Non-operating items included in net income of the Partnership in 2009 totalled $1.4 million, an improvement of $5.9 million when compared to 2007. The improvement in non-operating items is primarily the result of a foreign exchange gain on translation of US dollar denominated long-term debt, partially offset by a foreign exchange loss on working capital.

OPERATING RESULTS BY BUSINESS SEGMENT

Pulp

(millions of dollars unless otherwise noted, unaudited)	**2009**	2008
Sales[1]	**690.0**	695.2
EBITDA	**57.9**	116.7
EBITDA margin	**8%**	17%
Operating income	**11.7**	72.5
Average NBSK pulp list price – (US$ per tonne, delivered to USA)	**718**	857
Average NBSK pulp list price – (Cdn$ per tonne, delivered to USA)	**820**	914
Production – pulp (000 mt)	**1,006.8**	932.8
Shipments – Partnership produced pulp (000 mt)	**1,044.6**	905.4
Marketed on behalf of HSLP & Canfor (000 mt)	**521.7**	495.7

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

For the year ended December 31, 2009, operating income of $11.7 million was $60.8 million lower than in 2008. The decline in operating results was attributable to lower realized prices in Canadian dollar terms, partially offset by lower unit manufacturing costs and higher shipment volumes. Realized pulp prices in Canadian dollar terms were 14% lower when compared to 2008 as a 16% decrease in NBSK pulp US dollar list price and a higher percentage of sales into lower margin business, were partially offset by the weaker Canadian dollar. Energy sales under the terms of the new Energy Purchase Agreement with BC Hydro totalling $1.9 million in 2009 (2008 – nil) were included in the pulp segment sales. Unit manufacturing costs decreased by 10% when compared to 2008 due to the impact of higher production volumes, lower fibre, chemical and energy costs, and the impact of cost reduction initiatives. The production volume increase of 74,000 tonnes or 8% was mainly the result of increased operating days due to fewer scheduled maintenance shuts, reduced market curtailment days, and the impact of the Prince George Pulp and Paper Mill fire in 2008. Fibre costs decreased by approximately 13% when compared to 2008 due to lower prices for residual and whole log chips, partially offset by an increase in volume of higher cost whole log chips. Sales volumes of NBSK market pulp increased by 139,200 tonnes when compared to the prior year. The increased shipments of market pulp were attributable to the Partnership having more volume available for sale as a result of the increase in production and increased demand from Asia.

Operations

An annual production record of 313,565 tonnes was achieved at the Intercontinental Pulp Mill in 2009 surpassing the previous record set in 2004 by 5,400 tonnes.

NBSK market pulp production during 2009 was 74,000 tonnes higher than in 2008. The increased production was attributable to decreased scheduled maintenance outages, a fire at the Prince George Pulp and Paper Mill in 2008, and the market curtailment. The Prince George Pulp and Paper Mill fire reduced production by approximately 37,000 tonnes in 2008.

A curtailment of operations due to poor market conditions at all Partnership facilities commenced in the third week of December 2008 and was completed in January 2009. The curtailment was taken to mitigate the impact of a reduction in global demand and subsequent increase in inventory levels of pulp and paper.

Markets – Pulp

A significant number of pulp mills were idled during 2009, either indefinitely or permanently, which kept supply constrained, resulting in significant reductions in producer inventory stocks. Although full year 2009 Pulp and Paper Products Council statistics indicate that global demand for printing and writing papers was down 11% compared to 2008, there has been steady improvement in monthly demand since the end of the first quarter of 2009.

The steady improvement in consumption and continued reduction of supply has resulted in lower pulp inventories. At the end of December 2009, World 20[1] producers of bleached softwood pulp inventories stood at 23 days of supply. By comparison, December 2008 inventories stood at 40 days of supply. Market conditions are generally considered balanced when inventories fall in the 27-30 days of supply range.

As a result of these tight market conditions, producers were successful at implementing price increases consistently during the last three quarters of 2009. These price increases, from the bottom of the market in April 2009 totalled US$195 per tonne or 30%, bringing December list prices before discounts in the US and Northern Europe markets to US$830 and US$800 per tonne respectively, and China, with no discounts, to US$710 per tonne. In Canadian dollar terms the price increases were somewhat mitigated by a 20% strengthening of the Canadian dollar over the same period.

Note: [1] World 20 data is based on twenty producing countries representing 80% of world chemical market pulp capacity and is based on information compiled and prepared by the Pulp and Paper Products Council.

Outlook – Pulp

The market is expected to remain strong through the first quarter of 2010 due to strong seasonal demand. Approximately 12% of global capacity is still idled and some mill restarts will help ease the current supply shortfall. Inventories held by producers and customers are at low levels compared to what is considered a balanced market. With the supply/demand balance still in the favour of producers, there is potential for further price increases in March or April. Any relative weakness of the US dollar versus the Canadian dollar and the Euro will also exert upward pressure on US dollar list prices.

Paper

(millions of dollars unless otherwise noted, unaudited)	**2009**	2008
Sales[1]	**122.5**	130.3
EBITDA	**13.9**	13.1
EBITDA margin	**11%**	10%
Operating income	**10.6**	9.4
Production – paper (000 mt)	**131.0**	132.6
Shipments – paper (000 mt)	**135.0**	124.8

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

The 2009 operating results for the paper segment were $1.2 million favourable when compared to 2008. The increase was attributable to lower unit manufacturing costs and higher sales volumes, partially offset by a 13% drop in realized prices in Canadian dollar terms. Lower unit manufacturing costs were the result of lower costs for slush pulp, which is transferred to the paper segment at market price, and the impact of cost reduction initiatives in 2009. Shipments increased by 8% when compared to 2008.

Operations

Paper production in 2009 decreased by 1,600 tonnes when compared to 2008. The decrease was attributable to fewer operating days due to the scheduled maintenance outage in 2009 and the impact of the market curtailment, partially offset by the impact of the Prince George Pulp and Paper Mill fire in 2008. The Partnership commenced a curtailment of paper production in the third week of December 2008 which extended into January 2009, reducing paper production by approximately 3,400 tonnes in 2008 and approximately 4,800 tonnes in January 2009.

Markets

Weak North America kraft paper demand continued into the first half of 2009 due to the global recession and low consumer confidence. However, demand showed signs of improvement in the last two quarters of 2009 compared to the previous two quarters as customer inventory destocking appears to have been largely completed. The American Forest and Paper Association reported that US total kraft paper shipments for December 2009 increased by 1% from November and by 20% when compared to December 2008. Full year 2009 shipments were 12% lower when compared to the same period in 2008. The Paper Shipping Sack Manufacturers' Association shipping sack statistics for 2009 revealed that industry paper consumption was down by 13% from the previous year.

The Partnership's total prime paper shipments in 2009 increased by 5% when compared to 2008, and prime bleached shipments decreased by 21% from the prior year. Prime bleached shipments in 2009 were constrained by the Partnership's prime bleached production, which declined by 23% when compared to 2008.

Outlook – Kraft Paper

Demand is expected to remain strong through the first quarter of 2010. Prices are expected to increase as price announcements in the fourth quarter of 2009 are expected to be fully implemented in all markets in the first quarter of 2010. The benefit of increased prices in US dollar terms is vulnerable to the relative strength of the Canadian dollar in relation to other currencies, primarily the US dollar.

Non-Segmented Costs

(millions of dollars, unaudited)	**2009**	2008
Net unallocated costs	**10.3**	13.2
Interest expense, net	**10.1**	8.1
Foreign exchange (gain) loss on long-term debt	**(19.6)**	26.0
Loss on derivative financial instruments	**1.5**	8.9
Foreign exchange loss (gain) on working capital	**6.7**	(13.1)
Net property damage insurance gain	**(0.2)**	(8.2)
Other expense	**0.1**	0.2
	8.9	35.1

Unallocated Costs

Unallocated costs, comprised principally of general and administrative expenses, for 2009 of $10.3 million were $2.9 million lower than the same period a year ago. The lower costs were primarily attributable to cost reduction initiatives and settlement of an outstanding legal claim.

Interest Expense

The increased net interest expense in 2009 was due to the cost of funding short-term working capital requirements and fees relating to the new financing facility.

Other Non-segmented Items

The foreign exchange gain on long-term debt resulted from translating the US$110 million debt at the year-end exchange rate.

The net loss of $1.5 million on derivative financial instruments recorded in 2009 relates to the settlement of maturing contracts during the year and the revaluation to market of outstanding contracts at the end of the year for natural gas swaps and US dollar forward contracts.

The declining price of natural gas in 2009 resulted in a loss for the year of $7.6 million on settlement of contracts. The natural gas swaps are used to fix the price on a portion of the Partnership's future natural gas requirements. The increasing value of the Canadian dollar in 2009 resulted in a gain of $4.0 million on the settlement of US dollar forward contracts, which were used to mitigate the impact of currency fluctuations on US dollar working capital. This gain was offset by the foreign exchange loss on working capital of $6.7 million.

A net gain of $2.1 million was recorded in the year on outstanding derivative financial instruments relating to a revaluation to market of outstanding natural gas swaps and outstanding US dollar forward contracts at December 31, 2009.

SELECTED QUARTERLY PARTNERSHIP FINANCIAL INFORMATION

(millions of dollars unless otherwise noted, unaudited)	**Q4 2009**	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Sales and Income								
Sales	**220.2**	202.0	205.0	186.3	186.1	215.4	212.6	211.4
Operating income (loss)	**14.4**	12.4	(5.0)	(9.8)	(1.0)	27.5	11.6	30.6
EBITDA	**27.3**	25.1	7.2	2.2	9.8	40.6	24.0	42.5
Net income (loss)	**15.2**	18.3	1.5	(21.6)	(26.0)	11.1	18.2	43.5
Per Partnership unit (dollars) [1]								
Net income (loss) basic and diluted	**$0.21**	$0.26	$0.02	($0.30)	($0.36)	$0.15	$0.26	$0.61
Statistics								
Pulp shipments (000 mt)	**258.6**	259.5	286.2	240.3	208.2	234.5	233.8	228.9
Paper shipments (000 mt)	**38.1**	37.4	34.3	25.2	24.4	31.6	33.7	35.1
Average exchange rate (US$/Cdn$) [2]	**0.947**	0.912	0.858	0.803	0.825	0.960	0.990	0.996
Average NBSK pulp list price – (US$ per tonne, delivered to USA)	**820**	733	645	673	787	880	880	880
Per Partnership unit (dollars) [1]								
Adjusted distributable cash per unit[3]	**$0.31**	$0.16	$0.02	($0.06)	$0.02	$0.54	$0.19	$0.60
Distributions declared per unit	**$0.14**	$0.03	$0.03	$0.06	$0.28	$0.36	$0.36	$0.36

Notes: [1] Based on Partnership units outstanding at December 31, 2009 (71,270,025) for all periods.
[2] Source – Bank of Canada (average noon rate for the year).
[3] For further details on the Partnership's adjusted distributable cash see the Partnership's disclosure on pages 26 and 27.

Sales are primarily influenced by changes in market pulp prices, sales volumes and fluctuations in Canadian dollar exchange rates. Operating income (loss), net income (loss) and EBITDA are primarily impacted by: the level of sales; freight costs; fluctuations of fibre, chemical, and energy prices; level of spending and the timing of scheduled maintenance downtime; and production curtailments. Net income (loss) is also impacted by fluctuations in Canadian dollar exchange rates, the market price of natural gas, the revaluation to the year-end rate of US dollar denominated working capital balances and long-term debt, and revaluation of outstanding natural gas swaps and US dollar forward contracts.

SUMMARY OF FINANCIAL POSITION

The following table summarizes the Partnership's financial position as at the end of and for the following years:

(millions of dollars, except for ratios, unaudited)	**2009**	2008
Ratio of current assets to current liabilities	**2.04**	1.91
Ratio of net debt to partners' equity [1]	**0.19**	0.30

Increase (decrease) in cash and cash equivalents	**13.1**	(2.2)
Comprised of cash flow from (used in):		
Operating activities	**71.2**	105.2
Financing activities	**(40.9)**	(77.5)
Investing activities	**(17.2)**	(29.9)

Note: [1] Net debt consists of long-term debt and operating loans, net of cash and cash equivalents.

Changes in Financial Position

For the year, operating activities generated cash of $71.2 million compared to $105.2 million in 2008. The decrease was primarily due to lower cash generated from operations, partially offset by a decrease in cash used in working capital. The lower cash generated from operations was primarily attributable to reductions in the price for the Partnership's pulp and paper products, partially offset by lower unit manufacturing costs. The decrease of cash used in working capital was primarily the result of a decrease in the volume and price of chip inventories and pulp and paper finished goods inventories, and receipt of the outstanding insurance claim relating to the business interruption component of the Prince George Pulp and Paper Mill fire that occurred in 2008, partially offset by an increase in trade accounts receivable as a result of higher relative shipment volumes in the latter part of 2009.

The cash used in financing activities of $40.9 million represented $15.7 million of distributions paid to the limited partners, namely Canfor and the Fund, and a repayment of $25.2 million of the Partnership's bank credit facility.

The cash used in investing activities in the year was comprised primarily of $17.3 million relating to capital expenditures. A payment to BC Hydro totalling $4.3 million was included in capital expenditures in the third quarter of 2009. This represented a payment to reduce the Partnership's obligation for power production from the cogeneration project at the Prince George Pulp and Paper Mill. The obligation to produce power for the remainder of the term of the agreement, extending to August 2020, was reduced to 338 GWh per year from 390 GWh effective September 15, 2009.

FINANCIAL REQUIREMENTS AND LIQUIDITY

Long-term Debt

At December 31, 2009 the Partnership had outstanding long-term debt of $115.1 million (2008 – $134.7 million, US$110.0 million for both 2008 and 2009) in the form of unsecured US 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.

Operating Loans

At the end of the year, the Partnership had cash and cash equivalents of $13.5 million. On September 30, 2009 the Partnership completed a new $40 million bank credit facility with a maturity date of November 30, 2011, of which $0.5 million was utilized at December 31, 2009 for a standby letter of credit issued for general business purposes. In addition, the Partnership has arranged a separate facility with a maturity date of November 30, 2011, to cover the $16.0 million standby letter of credit issued to BC Hydro under the Energy Purchase Agreement. The general terms and conditions of the new financing are similar to the previous bank credit facility, with interest and other costs at prevailing market rates. The leverage ratio and interest coverage ratio remain consistent with the financial covenants under the long-term Note agreement, which agreement was unchanged and not affected by the new bank financing.

Cash Management

The Partnership manages cash resources to fund current and future operations through management of its capital structure in conjunction with cash flow forecasting, including anticipated investing and financing activities. The Partnership uses the bank credit facility to meet short-term working capital requirements. The Partnership also reviews on an ongoing basis, the level of distributions, capital expenditures and timing of scheduled major maintenance outages and may adjust these periodically to manage cash resources.

The Partnership also discounts letters of credit on outstanding trade receivables to reduce borrowing costs, to reduce credit and foreign currency exposure, and to increase short-term liquidity.

Debt Covenants

The Notes and bank credit agreements each contain similar financial covenants including a maximum allowable debt:EBITDA leverage ratio and minimum required EBITDA:interest coverage ratio. The Partnership remained in compliance with all covenants at December 31, 2009 and throughout the year.

Pulp and Paper Green Transformation Program

On October 9, 2009 the Canadian federal government announced the allocation of credits from the billion dollar Pulp and Paper Green Transformation Program (the Program). The Partnership was allocated $122.2 million from the Program announced by the Canadian government on June 17, 2009. The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. Credits may be used until the program end date of March 31, 2012. The Partnership identified and will be submitting a number of projects for Program approval. These projects are expected to provide economic and environmental benefits to the Partnership's operations.

Commitments

The Partnership is committed to the following operating leases for property, plant and equipment. At December 31, 2009, the future minimum lease payments under these operating leases were as follows:

(millions of dollars)	
2010	2.3
2011	1.7
2012	0.8
Thereafter	1.0
Total minimum lease payments	5.8

Other contractual obligations not included in the table above are:

- The Partnership finalized an amending Energy agreement with BC Hydro effective September 15, 2009 which provides for the sale of power production that exceeds an amended commitment of the original cogeneration project at the Prince George Pulp and Paper Mill. The obligation to produce power for the remainder of the term of the agreement, extending to August 2020, was reduced to 338 GWh per year from 390 GWh effective September 15, 2009. Under the agreement, the Partnership is required to post a standby letter of credit as security in annually decreasing amounts as minimum required amount of electricity are generated. As of December 31, 2009, the Partnership had no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of $16.0 million was issued to BC Hydro as security for future power generation commitments.

- Obligations to pay pension and other post-employment benefits, for which a liability of $49.0 million was recorded at December 31, 2009 (2008 - $46.7 million). The Partnership has funded and unfunded defined benefit plans, as well as a defined contribution plan, that provide pension and other retirement and post-employment benefits to all salaried employees and to its hourly employees that are covered under collective agreements. The regular Salary Pension Plan (SPP) is a registered pension plan and as such, requires funding of future obligations.

- The Partnership's asset retirement obligations represent estimated undiscounted future payments of $40.6 million to remediate the landfills at the end of their useful lives. Payments relating to landfill closure costs are expected to occur at periods ranging from 32 to 40 years which have been discounted at 5.8% and 6.3%, respectively. The estimated fair value is $3.0 million and the amount is included in long-term liabilities.

Pension Obligations

A new funding valuation as of December 31, 2009 is currently being performed for certain pension plans of the Partnership. The Partnership estimates that the cash funding contributions required for 2010 will likely be between $4.5 million and $6.5 million, in part dependent upon the amortization period of the funding deficit (5 or 10 years, subject to regulatory approval). Of this amount, approximately $2.5 million will relate to current service costs of active employees.

RELATED PARTY TRANSACTIONS

The Partnership purchased wood chips and hog fuel from Canfor sawmills in the amount of $119.4 million in 2009 (2008 — $144.5 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 2009 were $3.9 million (2008 — $6.0 million). The Partnership sold wood chips to Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, in the amount of $0.1 million (2008 — $0.7 million). 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 2009 was $3.0 million (2008 — $3.3 million), included in manufacturing and product costs and selling and administration 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 2009 was $1.7 million (2008 — $1.8 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 (Taylor) for which it earned commissions totalling $1.9 million in 2009 (2008 — $2.0 million), included in sales. The Partnership also purchased chemi-thermo mechanical pulp from Taylor for resale totalling $1.7 million in 2009 (2008 — $3.5 million). The Partnership sold NBSK pulp to Taylor for packaging use totalling $2.3 million in 2009 (2008 — $2.2 million). In respect of the products marketed and services provided for Taylor, the Partnership held balances of $24.4 million in accounts receivable - trade (2008 — $9.9 million) and $24.5 million in accounts payable (2008 — $12.2 million) to Canfor at December 31, 2009.

The Partnership markets the NBSK pulp produced by HSLP, for which it earned commissions totalling $2.4 million in 2009 (2008 — $2.6 million), included in sales. In respect of the products marketed and service provided for HSLP, the Partnership held balances of $16.5 million in accounts receivable - trade (2008 — $16.9 million) and $17.6 million in accounts payable (2008 — $20.4 million) to HSLP at December 31, 2009.

Under the agreements for the marketing of production from HSLP and Taylor, the Partnership assumes the customer credit risk. Accordingly, the Partnership records on its balance sheet the accounts receivable from the customer and the accounts payable to HSLP and Canfor for sales made under those agreements.

At December 31, 2009, a total of $16.3 million (2008 — $15.2 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, 2009 a total of $0.4 million (2008 — $0.2 million) was payable to Lakeland Mills Ltd. for wood chips.

During 2009, the Partnership declared distributions totalling $18.6 million to its limited partners. Distributions to Canfor were $9.4 million, of which $6.5 million was paid, with the balance of $2.9 million payable on December 31,

2009. Distributions to the Fund were $9.2 million, of which $6.4 million was paid, with the balance of $2.8 million payable on December 31, 2009. For the year ended December 31, 2008, the Partnership declared distributions totalling $96.9 million to its limited partners. Distributions to Canfor were $48.6 million, of which $47.2 million was paid, with the balance of $1.4 million payable on December 31, 2008. Distributions to the Fund were $48.3 million, of which $46.9 million was paid, with the balance of $1.4 million payable on December 31, 2008.

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.

FOURTH QUARTER 2009 RESULTS

EBITDA for the fourth quarter of 2009 increased by $17.5 million when compared to the fourth quarter of 2008. The improved results when compared to the fourth quarter of 2008 were primarily attributable to lower unit manufacturing costs, higher sales volumes, lower freight costs and higher NBSK pulp US dollar list prices, partially offset by a stronger Canadian dollar and lower realized paper prices in Canadian dollar terms. Realized pulp prices in Canadian dollar terms decreased by 7% as a 15% strengthening of the Canadian dollar was partially offset by a 4% increase in NBSK pulp US dollar list prices, and the impact of a higher proportion of sales in the fourth quarter of 2008 into lower margin business. Paper prices decreased by 23% when compared to the fourth quarter of 2008 due to the stronger Canadian dollar and the impact of weak markets as a result of global reductions in paper demand. Lower unit manufacturing costs were the result of higher production volumes, lower fibre costs, lower chemical and energy prices, and other cost reduction initiatives. Production volumes were higher primarily as a result of the market curtailment in December 2008. The lower freight costs were attributable to a reduction in fuel surcharges and lower container rates.

NBSK market pulp production during the fourth quarter was 12,500 tonnes lower than the third quarter of 2009, and 32,300 tonnes higher than the fourth quarter of 2008. The reduced production when compared to the prior quarter was a result of the scheduled maintenance outage completed at the Northwood Pulp Mill in the fourth quarter of 2009 with no scheduled maintenance downtime taken in the prior quarter. The increase in market pulp production when compared to the same period in the prior year was largely attributable to the market curtailment taken in December 2008 to mitigate the impact of a reduction in global demand and subsequent increase in inventory levels of pulp and paper.

The fourth quarter 2009 operating income of the pulp segment increased by $18.3 million when compared to the same period a year ago, due to lower unit manufacturing costs, higher sales volumes and higher NBSK pulp US dollar list prices, partially offset by a stronger Canadian dollar. Realized pulp prices in Canadian dollar terms decreased by 7% as a 15% strengthening of the Canadian dollar was partially offset by a 4% increase in NBSK pulp US dollar list prices. Energy sales under the terms of the new Energy Purchase Agreement with BC Hydro totalling $1.9 million in the fourth quarter of 2009 (fourth quarter 2008 – nil) are included in the pulp segment sales. Lower unit manufacturing costs were the result of higher production volumes, lower fibre costs, lower chemical and energy prices, and other cost reduction initiatives. Production volumes were higher primarily as a result of the market curtailment in December 2008.

Operating income of the paper segment for the fourth quarter of 2009 was $2.4 million lower than the same period last year. The reduction in operating earnings was due to a 23% decrease in realized prices in Canadian dollar terms, partially offset by higher sales volumes and lower unit manufacturing costs. The decrease in paper prices was due to the stronger Canadian dollar, and the impact of weak markets as a result of global reductions in paper demand. Lower unit manufacturing costs were primarily attributable to lower costs for slush pulp and higher production volumes. Production volumes were higher primarily as a result of the market curtailment in December 2008. Sales volumes were higher by 13,700 tonnes due to the market curtailment and weak demand in the fourth quarter of 2008.

The unallocated costs, comprised principally of general and administrative expenses, totalled $3.6 million in the fourth quarter of 2009 compared to $3.1 million in the fourth quarter of 2008. The increase in unallocated costs was mainly due to higher accruals for performance based incentive plans, partially offset by lower net legal expenses.

More detailed analysis of the fourth quarter 2009 results can be found in the Fourth Quarter 2009 press release dated February 5, 2010.

RISKS AND UNCERTAINTIES RELATED TO THE BUSINESS AND INDUSTRY

Cyclicality 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 prices of pulp have 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 US dollar, as prices for the Partnership's products are denominated in US dollars or linked to prices quoted in US dollars. Therefore, an increase in the value of the Canadian dollar relative to the US dollar reduces the amount of revenue in Canadian dollar terms realized by the Partnership from sales made in US dollars, which in turn, reduces the Partnership's operating margin and the cash flow available to fund distributions.

Dependence on Canfor

Approximately 63% 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 price 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 US 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 2009, the Partnership's top three customers accounted for approximately 20% of its pulp sales. The Partnership is therefore dependent on these customers. In the event that the Partnership cannot maintain these customer relationships or the demand from these customers is diminished 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 if 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 operations 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.

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 were approximately $13.5 million during 2009, and it expects to spend about $36.0 million on capital expenditures during 2010, of which approximately $16.0 million will qualify for Canadian Federal government funding in respect of qualifying Green Transformation Program projects. 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, 2012. 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 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 a 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 on third parties for transportation of its products, as well as delivery of raw materials principally by railroad, trucks and ships. If any significant 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 be unable to manufacture its products in response to customer demand, which may have a material adverse effect on its financial condition and operating results. In addition, if any of these significant third parties were to cease operations or cease doing business with the Partnership, the Partnership may be unable to replace them at a reasonable cost.

Senior Management

The Partnership's success depends, in part, on the efforts of its senior management. The senior management team 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 provided by one or more of its 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 the Partnership 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 $3.0 million as of December 31, 2009 (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, the Partnership's liability may exceed forecasted amounts. The discovery of additional contamination or the imposition of additional cleanup obligations at the Partnership's or third-party sites may result in significant additional costs. Any material expenditure incurred could adversely impact the Partnership's financial condition or preclude the Partnership from making capital expenditures that would otherwise benefit the Partnership's 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 the 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	$ 6
NBSK pulp – US $10 change per tonne	6
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 asset useful lives for amortization, impairment of long-lived assets, pension and other employee future benefit plans, asset retirement obligations, and provisions for insurance claims, 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.

The Partnership reviewed the carrying values of the pulp and paper finished goods inventories as at December 31, 2009. The Partnership estimates the net realizable value of the finished goods inventories based on actual and forecasted sales orders and as a result recorded a write-down to net realizable value on paper finished goods inventories of $0.1 million at December 31, 2009.

On an ongoing basis, management reviews the asset retirement obligations in respect of useful lives and landfill closure costs. The obligations represent estimated undiscounted future payments of $40.6 million. Payments relating to landfill closure costs are expected to occur at periods ranging from 32 to 40 years which have been discounted at 5.8% and 6.3% respectively.

CHANGES IN ACCOUNTING POLICIES

Financial Instrument Disclosures

In June 2009, the CICA amended Handbook Section 3862, Financial Instruments – Disclosures, to enhance disclosures about fair value measurements and the liquidity risk of financial instruments. These amendments are intended to provide further detail on the relative reliability of the data or inputs used to measure the fair value of the entities financial instruments. Specifically, financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The Partnership has incorporated this amendment into the audited consolidated financial statements.

FINANCIAL INSTRUMENTS

Periodically, the Partnership uses derivative instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, pulp prices, and natural gas prices.

For the year ended December 31, 2009 the Partnership recorded a net loss on derivative financial instruments of $1.5 million (2008 – $8.9 million) relating to the settlement of maturing contracts during the year and the revaluation to market of outstanding contracts at the end of the year, for natural gas swaps and US dollar forward contracts.

For the year ended December 31, 2009 the Partnership recorded losses of $7.6 million (2008 – gain of $0.5 million) relating to the settlement of maturing natural gas swaps as a charge to non-operating income. At December 31, 2009 the Partnership had outstanding commodity swaps hedging future natural gas purchases of 1.7 million gigajoules extending to October 2011. At December 31, 2009 the unrealized loss of $3.5 million (2008 – $3.2 million) on these outstanding commodity swaps was recorded as a liability in accounts payable and accrued liabilities and in long-term liabilities.

For the year ended December 31, 2009 the Partnership recorded a net gain of $4.0 million (2008 – losses of $7.8 million) on settlement of maturing US dollar forward contracts as a credit to non-operating income. At December 31, 2009 the Partnership had outstanding US dollar forward contracts of $77.8 million extending to March 2010. At December 31, 2009 the unrealized gain of $1.1 million (2008 – loss of 1.3 million) on these outstanding US dollar forward contracts was recorded as an asset in other accounts receivable.

OUTSTANDING UNITS

At February 5, 2010, 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) were owned by the Fund through the Trust and 35,776,483 Class B Exchangeable Limited Partnership Units were owned indirectly by Canfor.

DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

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. The Partnership's chief executive officer (CEO) and chief financial officer (CFO) evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2009, and have concluded that they were operating effectively.

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting (ICFR), and confirmed that there were no changes in these controls that occurred during the most recent year ended December 31, 2009 which materially affected, or are reasonably likely to materially affect, the Partnership's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2009, the CEO and CFO have concluded that these controls were operating effectively.

CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

On February 13, 2008, the Accounting Standards Board (AcSB) announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The Partnership intends to convert to these new standards according to the timetable set for these new rules.

The Partnership has substantively completed the detailed diagnostic activities of its transition plan. Differences between IFRS and Canadian generally accepted accounting principles (GAAP), in addition to those referenced below, may continue to be identified based on further detailed analyses by the Partnership and other changes in IFRS prior to the Partnership's conversion to IFRS in 2011.

The Partnership anticipates additional disclosure resulting from the adoption of IFRS and is identifying and assessing these additional disclosure requirements, as well as systems changes if any, that will be necessary to compile the required disclosures.

The key elements of the transition plan are as follows:

Project Structure

The Partnership has appointed a dedicated project manager to lead the conversion to IFRS. The project manager is working with other members of the finance team to execute the implementation plan. The Partnership's finance team completed detailed training on IFRS standards and preliminary policy choices in 2009. An implementation team is working closely with senior management in a number of different business areas to ensure that the impacts of the conversion throughout the business are managed in a timely and efficient manner. A steering committee has been established to oversee the project. On a quarterly basis, the Partnership's Audit Committee is updated on the progress of the conversion plan.

Process and Timing

The process of converting to IFRS has been divided into a number of different stages, many of which will run concurrently. A detailed analysis is substantively complete and a number of accounting policy choices have been recommended by the Steering Committee but have not been finalized. At December 31, 2009, the full impact that adopting IFRS would have on the Partnerships' financial statements could not be reasonably determined, as the current status of the project reflected the Partnership's most recent assumptions and expectations; circumstances may arise, such as changes in existing IFRS, or changes in the regulatory or economic environment, which could alter these assumptions and/or expectations. These disclosures reflect the Partnership's expectations based on information available at December 31, 2009. Changes in IFRS standards or circumstances relating to the Partnership may cause the Partnership to revise its expectations, its project plan, and its potential IFRS accounting policy choices prior to the conversion date.

No significant changes to information technology systems or business processes have been identified to date. The implementation team will continue to assess the impact on systems as the project progresses.

A draft opening balance sheet prepared under IFRS at the date of transition (January 1, 2010) is currently planned to be completed during 2010. Draft financial statements and disclosure information will be prepared for each quarter in 2010 (to be used for comparative purposes in 2011) and reporting under IFRS will commence for interim and annual periods in 2011.

Progress to Date

At December 31, 2009, the Partnership had substantively completed a detailed diagnostic of the impact of IFRS on the Partnership's financial statements. Set out below are the key areas where changes in accounting policies are expected that may materially impact the Partnership's consolidated financial statements. The list and comments below should not be regarded as a complete list of changes that will result from the transition to IFRS. It is intended to highlight the more significant areas the Partnership has identified to date; however, the analysis of changes is still in progress and not all decisions have been finalized where choices of accounting policies are available.

Accounting Policy Impacts and Decisions

- Property, plant and equipment (PP&E):

  For major maintenance, International Accounting Standard (IAS) 16 allows for major inspections and overhauls to be accounted as a separate component of PP&E if the component is used for more than one reporting period. This treatment is only intended for major expenditures that occur at regular intervals over the life of the asset as costs of routine repairs and maintenance will continue to be expensed as incurred. The major maintenance required on the Partnership's plant and equipment would likely qualify for treatment under this standard with major maintenance being classified as property, plant and equipment. Currently under Canadian GAAP major maintenance is classified as prepaid expense and other assets, and other long-term assets, as appropriate.

- Employee Benefits:

  IAS 19, "Employee Benefits", requires past service costs associated with defined benefit plans to be expensed on an accelerated basis, with vested past service costs expensed immediately and unvested past service costs recognized on a straight-line basis until the benefits become vested. Under Canadian GAAP, past service costs are generally amortized on a straight-line basis over the average remaining service period of active employees expected under the plan. In addition, actuarial gains and losses are permitted to be recognized immediately in other comprehensive income under IFRS rather than amortized through earnings, and IFRS 1 also provides an option to recognize immediately in equity all cumulative actuarial gains and losses existing as at the date of transition to IFRS.

- Impairment of Assets:

  Canadian GAAP generally uses a two-step approach to impairment testing: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists; and then measuring any impairment by comparing asset carrying values with fair values. IAS 36, "Impairment of Assets", uses a one-step approach for both testing for and measurement of impairment, with asset carrying values compared directly with the higher of fair value less costs to sell, and value in use. This may potentially result in more write-downs where carrying values of assets were not previously impaired under Canadian GAAP when compared to undiscounted cash flows, but could be impaired under IFRS when compared to fair value or value in use. However, the extent of any new write-downs may be partially offset by the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

- Provisions (Including Asset Retirement Obligations):

  IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", requires a provision to be recognized when there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation, where "probable" in this context, means more likely than not. The criteria for recognition in the financial statements under Canadian GAAP, is "likely", which is a higher threshold than "probable". Therefore, it is possible that there may be some contingent liabilities which would meet the recognition criteria under IFRS that were not recognized under Canadian GAAP. Other differences between IFRS and Canadian GAAP exist in relation to the measurement of provisions, such as the methodology for determining the best estimate where there is a range of equally possible outcomes (IFRS uses the mid-point of the range, whereas Canadian GAAP uses the low-end of the range), and the requirement under IFRS for provisions to be discounted where material.

Disclosure Controls and Internal Controls over Financial Reporting

Financial reporting controls will change due to the transition to IFRS. The majority of change surrounds new processes or modified processes, due to the fact that IFRS requires more judgment with respect to various accounting treatments. Processes and controls will be put in place to ensure the Partnership is making the appropriate judgments and following the IFRS accounting policies selected.

CANFOR PULP LIMITED PARTNERSHIP

SUPPLEMENTARY FINANCIAL INFORMATION

(millions of dollars, unaudited)	Year ended December 31, 2009	Year ended December 31, 2008
RECONCILIATION OF NET INCOME TO EBITDA		
Net Income	**$ 13.4**	$ 46.8
Add (deduct):		
Amortization	**49.4**	47.6
Net interest expense	**10.1**	8.1
Foreign exchange (gain) loss on long-term debt	**(19.6)**	26.0
Loss on derivative financial instruments	**1.5**	8.9
Foreign exchange loss (gain) on working capital	**6.7**	(13.1)
Loss on disposal of fixed assets	**0.2**	1.2
Net property damage insurance gain	**(0.2)**	(8.2)
Gain on settlement of asset retirement obligation	**-**	(0.9)
Other expense	**0.3**	0.5
EBITDA	**$ 61.8**	$ 116.9
EBITDA per Partnership unit	**$ 0.87**	$ 1.64

(millions of dollars, unaudited)	Year ended December 31, 2009	Year ended December 31, 2008
CALCULATION OF STANDARDIZED AND ADJUSTED DISTRIBUTABLE CASH		
Cash flow from operating activities	**$ 71.2**	$ 105.2
Deduct: Capital expenditures – cash	**(17.3)**	(30.0)
Standardized distributable cash	**$ 53.9**	$ 75.2
Adjustments to standardized distributable cash:		
Add (deduct):		
Increase (decrease) in non-cash working capital	**(31.8)**	14.4
Net long-term deferred maintenance	**4.6**	(0.5)
Capital expenditure accruals – net	**3.8**	4.7
Asset retirement obligation – current expenditures and accruals	**-**	2.3
Adjusted distributable cash	**$ 30.5**	$ 96.1
Standardized distributable cash – per Partnership unit (in dollars)	**$ 0.76**	$ 1.06
Adjusted distributable cash – per Partnership unit (in dollars)	**$ 0.43**	$ 1.35
Cash distributions declared (paid and payable)	**$ 18.6**	$ 96.9
Cash distributions declared – per Partnership unit (in dollars)	**$ 0.26**	$ 1.36

DISTRIBUTABLE CASH AND CASH DISTRIBUTIONS

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

Adjusted distributable cash is defined as the standardized distributable cash prior to the effects of changes in non-cash working capital and long-term deferred maintenance, asset retirement obligation expenditures and accruals, and after provision for accrued capital expenditures.

The Board determines the level of cash distributions based on the level of cash flow from operations before changes in non-cash working capital and long-term deferred maintenance, asset retirement obligation expenditures and accruals, less capital expenditures. In addition, management estimates of short-term liquidity requirements may influence the level of distributions. 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.

Distributions are declared monthly with date of record on the last day of the month and payable within 15 days following.