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Canfor Pulp Income Fund Annual Report 2009

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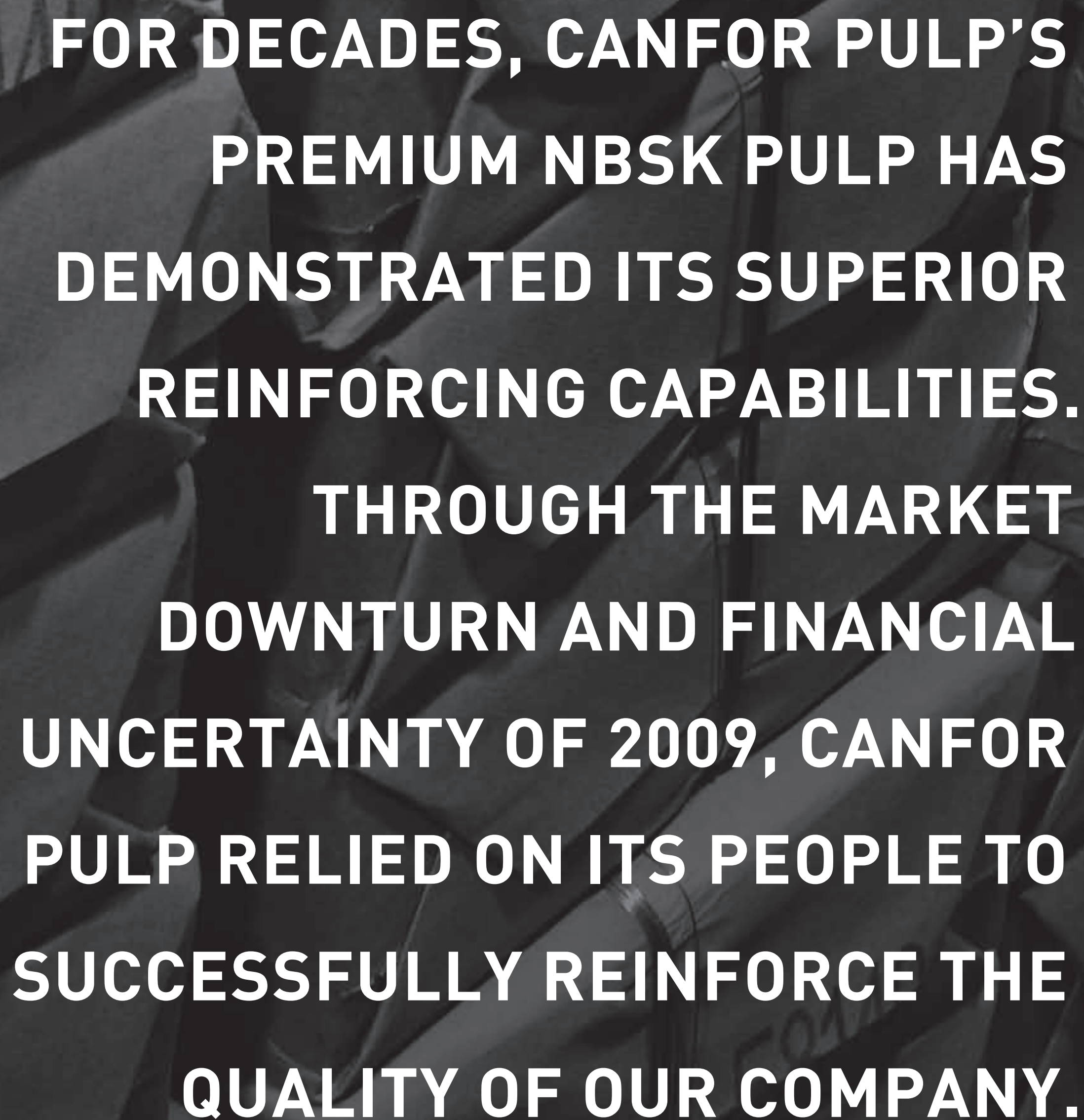


FOR DECADES, CANFOR PULP'S PREMIUM NBSK PULP HAS DEMONSTRATED ITS SUPERIOR REINFORCING CAPABILITIES. THROUGH THE MARKET DOWNTURN AND FINANCIAL UNCERTAINTY OF 2009, CANFOR PULP RELIED ON ITS PEOPLE TO SUCCESSFULLY REINFORCE THE QUALITY OF OUR COMPANY.

To Our Unitholders

2009 was a year of contrasts for the pulp markets and the broader economy. Canfor Pulp began the year with a continuation of market curtailments that had commenced in December of 2008. The precipitous decline in pulp demand during the fourth quarter of 2008 drove global pulp inventories to very high levels and resulted in depressed pulp prices in the first quarter of 2009. In response to these market conditions, pulp production curtailments were announced throughout the industry, and by the end of the first quarter almost 50% of the capacity of the Canadian pulp industry was curtailed for periods of eight weeks to indefinitely.

With curtailed supply, as pulp demand improved in the second quarter, particularly in China, global pulp inventories began to decline. Global producer pulp inventories declined from 43 days of supply at the beginning of the year to 23 days by the end of the year. Pulp prices which had fallen to a low of US$635 per tonne in April rose to US$850 per tonne by December. The value of the Canadian dollar in relation to the US dollar rose from 81.7 cents at the beginning of the year to 95.6 cents by year end. This strengthening of the Canadian dollar is in part responsible for the continued production curtailments by some Canadian producers.

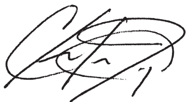
The worldwide credit crisis was particularly difficult for much of the year. In spite of these credit challenges, the refinancing of the maturing bank facilities was completed in September for a two year term at market rates.

The operational performance of the mills in 2009 improved over the previous year, with a production volume of 1.14 million tonnes compared to 1.07 million tonnes in 2008. Production costs were reduced for both wood chips and conversion costs, as a major effort on cost reduction resulted in an estimated $30 million of savings. The year ended with high wood chip inventories of more than 30 days of consumption and there is ample supply of sawmill residual and economic whole log chips available.

During the year the Canadian federal government introduced the Pulp and Paper Green Transformation Program, designed as a reimbursement of funds for capital improvements in energy consumption and environmental performance. Of the $1 billion Program, the Partnership was allocated credits of $122 million to be used prior to the program end date of March 31, 2012. The Partnership has identified and will be submitting a number of projects for funding approval.

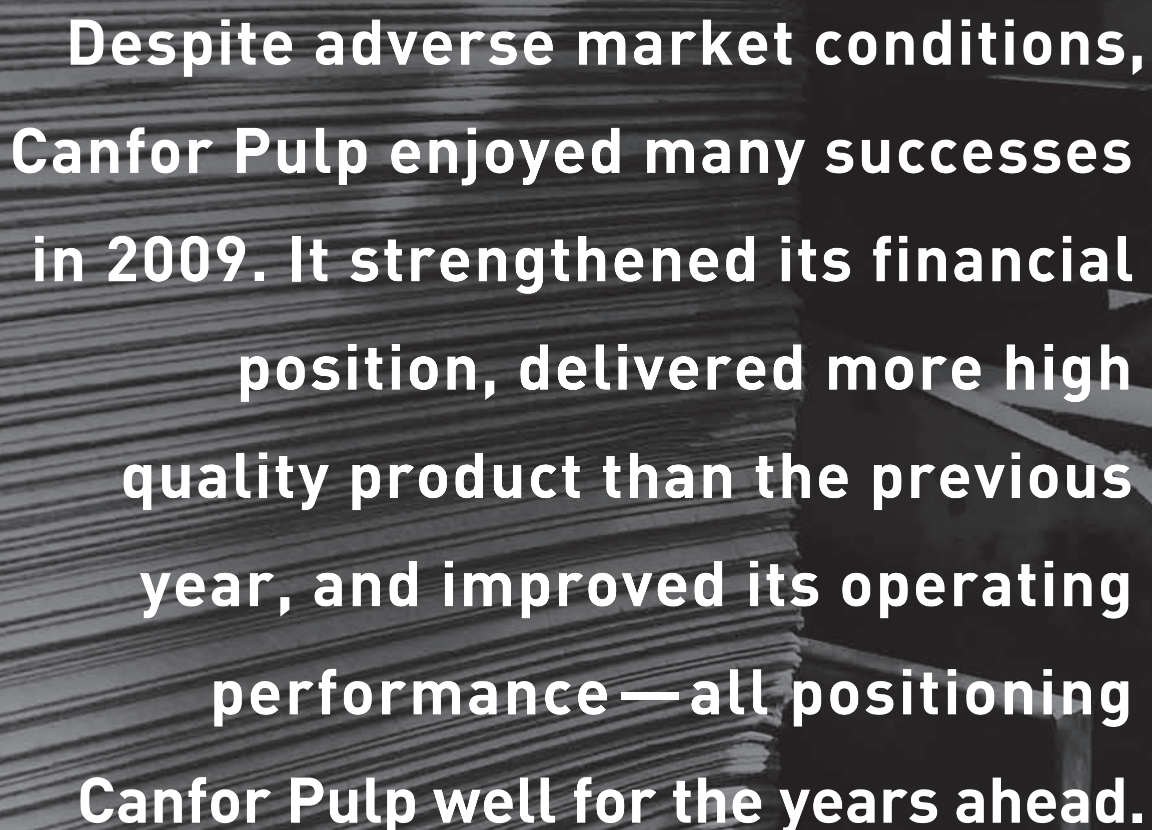
As we look forward into 2010, we are fortunate to have strong market fundamentals with positive pricing momentum, low global pulp inventories and a supply/demand balance favouring producers. During the year we intend to follow a course for conversion from a trust and income fund to a corporation, as the income tax advantages of the trust structure expire on January 1, 2011

We would like to thank our fellow Board members for their guidance and diligence. On behalf of the Board, we also thank our employees for their dedicated contributions to the company's success and thank you, our unitholders, for your continued support.



Dr. Charles Jago
Trustee, Canfor Pulp Income Fund
Chairman of the Board, Canfor Pulp Holding Inc.
the general partner of Canfor Pulp Limited Partnership

Paul Richards
President and Chief Executive Officer,
Canfor Pulp Holding Inc.
the general partner of Canfor Pulp Limited Partnership

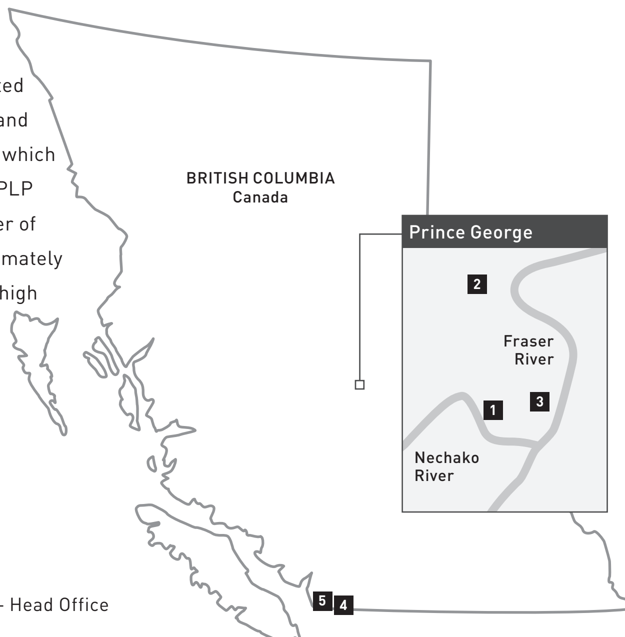


Despite adverse market conditions, Canfor Pulp enjoyed many successes in 2009. It strengthened its financial position, delivered more high quality product than the previous year, and improved its operating performance — all positioning Canfor Pulp well for the years ahead.

Operations and Ownership Structure

OPERATIONS

The Fund indirectly holds a 49.8% interest in Canfor Pulp Limited Partnership (CPLP). CPLP is a leading global supplier of pulp and paper products and operates three mills in Prince George, BC which are among the lowest cost NBSK pulp producers in Canada. CPLP is the largest North American and third largest global producer of market NBSK Pulp, with annual production capacity of approximately 1 million tonnes and is the leading producer of fully bleached, high performance Kraft Paper.

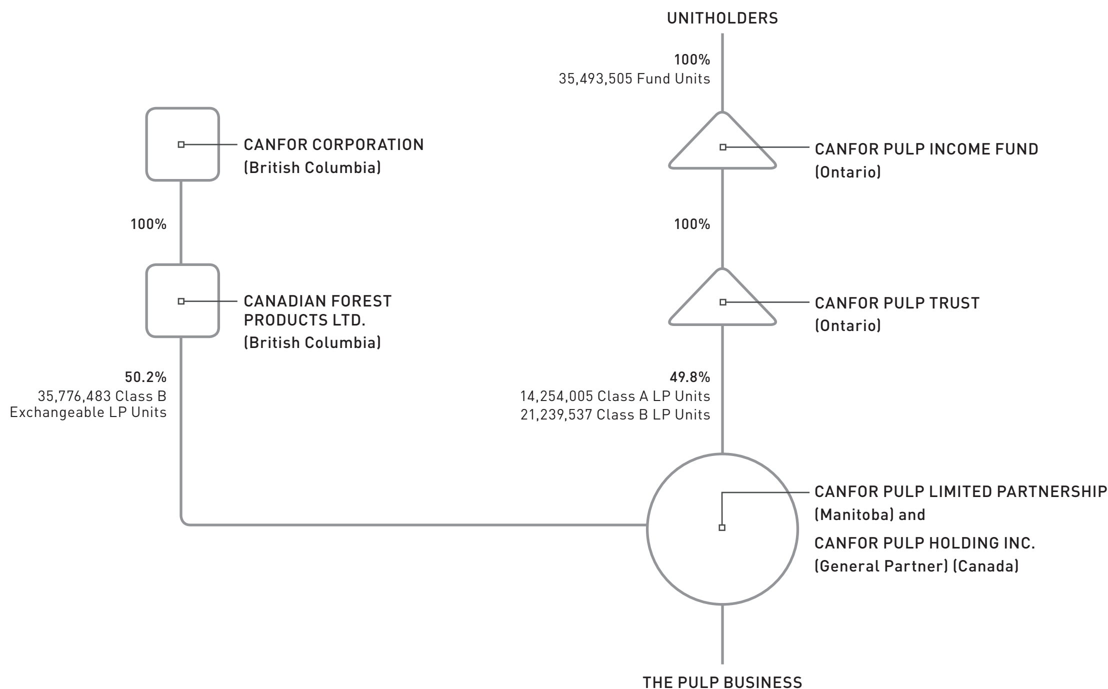


	Capacity **(tonnes)**	**Key Products**
Mills		
1 Intercontinental	315,000	Pulp
2 Northwood	590,000	Pulp
3 Prince George	155,000	Pulp
3 Prince George	140,000	Kraft Paper

Other

4 Canfor Pulp Limited Partnership / Canfor Pulp Income Fund – Head Office
5 Canfor Pulp Research and Development Centre

OWNERSHIP STRUCTURE



Management's Discussion and Analysis

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 10;
- "SIFT Conversion Rules" on page 11;
- "Conversion to International Financial Reporting Standards" on page 11;
- "Outlook – Pulp" on page 15;
- "Outlook – Kraft Paper" on page 16;
- "Financial Requirements and Liquidity" on pages 18 and 19;
- "Capital Requirements" on page 23;
- "Critical Accounting Estimates" on page 25;
- "Conversion to International Financial Reporting Standards" on pages 26 and 27;
- "Distributable Cash and Cash Distributions" on page 29.

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

(1) In 2009 the Fund recorded a non-cash future income tax recovery of $2.4 million compared to a non-cash future income tax 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 28 and 29.

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

(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 28 and 29.

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 26 to 28.

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. A simplified schematic of the ownership structure appears on page 4.

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 Pulp and Paper 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 Electricity Purchase 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

(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

(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 Electricity 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.

(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

(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 American 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$110.0 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

(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 28 and 29.

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)

(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 Electricity 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 Electricity Purchase 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 amounts 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 Electricity 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 Pulp and Paper 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 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 of Directors of the General Partner (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 Partnership's 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, except per unit amounts 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, except per unit amounts 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	$ 0.76	$ 1.06
Adjusted distributable cash – per Partnership unit	$ 0.43	$ 1.35
Cash distributions declared (paid and payable)	$ 18.6	$ 96.9
Cash distributions declared – per Partnership unit	$ 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.

Consolidated Financial Statements

MANAGEMENT'S RESPONSIBILITY

The information and representations in the financial statements and Management's Discussion and Analysis (MD&A) are the responsibility of Management and have been approved by the Board of Directors of Canfor Pulp Holding Inc. the general partner of Canfor Pulp Limited Partnership and by the Trustees of Canfor Pulp Income Fund. Management prepared the consolidated financial statements in accordance with accounting principles generally accepted in Canada and, where necessary, they reflect Management's best estimates and judgments at this time. It is reasonably possible that circumstances arise which cause actual results to differ. Management does not believe it is likely that any differences will be material. The financial information presented throughout this report is consistent with that contained in the consolidated financial statements.

Management is responsible for designing and maintaining adequate systems of internal controls over financial reporting, including policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of the assets, for both the Fund and the Partnership. The Partnership's chief executive officer and chief financial officer have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2009, and have concluded that they are operating effectively.

Canadian Forest Products Ltd. (Canfor)'s Internal Audit Department performs independent reviews of the accounting records and related procedures. The Internal Audit Department reports its findings and recommendations both to Management and the Audit Committee.

The Board of Directors and the Trustees are responsible for ensuring that Management fulfills its responsibilities for financial reporting and are ultimately responsible for reviewing and approving the financial statements and Management's Discussion and Analysis. The Board and Trustees carry out these activities primarily through the Audit Committee.

The Audit Committee is comprised of Directors and Trustees who are not employees of the Partnership. The Committee meets periodically throughout the year with Management, external auditors and internal auditors to review their respective responsibilities, results of the reviews of internal accounting controls, policies and procedures, and financial reporting matters. The external auditors meet separately with the Audit Committee.

The consolidated financial statements and Management's Discussion and Analysis have been reviewed by the Audit Committee, which recommended their approval by the Board of Directors and the Trustees. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, whose reports follow.

Paul Richards
President and Chief Executive Officer
Canfor Pulp Holding Inc.

Terry Hodgins
Chief Financial Officer and Secretary
Canfor Pulp Holding Inc.

Canfor Pulp Income Fund Consolidated Financial Statements

Audit Opinion

TO THE UNITHOLDERS OF CANFOR PULP INCOME FUND

We have audited the consolidated balance sheets of Canfor Pulp Income Fund (the "Fund") as at December 31, 2009 and December 31, 2008, and the consolidated statements of income, comprehensive income and accumulated earnings and distributions and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and December 31, 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC

February 05, 2010

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

(thousands of dollars, except unit and per unit amounts)	Year ended December 31, 2009	Year ended December 31, 2008
Income		
Equity income in Canfor Pulp Limited Partnership	$ 6,644	$ 23,280
Net income before future income taxes	6,644	23,280
Future income taxes (recovery) (note 7)	(2,422)	3,076
Net income	9,066	20,204
Distributions declared (note 5)	(9,229)	(48,271)
Distributions in excess of earnings	$ (163)	$ (28,067)
Weighted average number of Fund units	35,493,505	35,493,514
Net income per Fund unit, basic and diluted	$ 0.26	$ 0.57
Net income for the year	$ 9,066	$ 20,204
Equity interest in other comprehensive loss of Canfor Pulp Limited Partnership	(45)	(193)
Comprehensive income	$ 9,021	$ 20,011
Accumulated earnings and distributions		
Balance, beginning of year – distributions in excess of earnings	$ (72,863)	$ (44,796)
Distributions in excess of earnings – current year	(163)	(28,067)
Balance, end of year – accumulated distributions in excess of earnings	$ (73,026)	$ (72,863)

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

Canfor Pulp Income Fund
Consolidated Statements of Cash Flows

(thousands of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Cash generated from (used in)		
Operating activities		
Net income	$ 9,066	$ 20,204
Items not affecting cash:		
Equity income in Canfor Pulp Limited Partnership	(6,644)	(23,280)
Future income taxes (recovery)	(2,422)	3,076
Distributions received from Canfor Pulp Limited Partnership	7,809	51,111
	7,809	51,111
Financing activities		
Distributions paid to unitholders	$ (7,809)	$ (51,111)
Beginning, change and ending balance in cash and cash equivalents	$ –	$ –

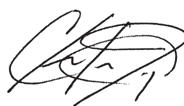
The accompanying notes are an integral part of these consolidated financial statements.

Canfor Pulp Income Fund
Consolidated Balance Sheets

(thousands of dollars)	As at December 31, 2009	As at December 31, 2008
ASSETS		
Current assets		
Distributions receivable from Canfor Pulp Limited Partnership (notes 5, 6)	$ 2,839	$ 1,420
Total current assets	2,839	1,420
Equity investment in Canfor Pulp Limited Partnership (note 4)	263,644	266,274
	$ 266,483	$ 267,694
LIABILITIES		
Current liabilities		
Distributions payable (note 5)	$ 2,839	$ 1,420
Total current liabilities	2,839	1,420
Future income taxes (note 7)	37,287	39,709
	40,126	41,129
UNITHOLDERS' EQUITY		
Unitholders' equity – 35,493,505 Fund units outstanding	299,351	299,351
Accumulated earnings and distributions	(73,026)	(72,863)
Accumulated other comprehensive income (note 8)	32	77
Total Unitholders' Equity	226,357	226,565
	$ 266,483	$ 267,694

Description of the Fund and basis of presentation of financial statements (note 1).
The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Trustees



Stan Bracken-Horrocks
Trustee

Charles Jago
Trustee

Canfor Pulp Income Fund – Notes to the Consolidated Financial Statements as at December 31, 2009 and 2008

1. DESCRIPTION OF THE FUND AND BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

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

These consolidated financial statements include the accounts of the Fund and the Trust.

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Fund and the Trust, its wholly-owned holding trust. All significant inter-company transactions have been eliminated.

INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

The Fund accounts for its investment in the Partnership using the equity method. Under the equity method the Fund records its pro-rata share of the Partnership's income as an increase in investment. Any distributions declared by the Partnership and accruing to the Fund reduce the carrying value of the Fund's investment in the Partnership.

USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise that cause actual results to differ from management estimates; however, management does not believe it is likely that such differences will materially affect the Fund's financial position. Significant areas requiring the use of management estimates are the valuation of the Fund's investment in the Partnership relative to its market value and the determination of future income tax.

NET INCOME PER FUND UNIT

Basic net income per Fund unit is based on the weighted average number of Fund units outstanding during the year. At December 31, 2009 and December 31, 2008 the Partnership had 35,776,483 Class B Exchangeable Limited Partnership Units outstanding which can be exchanged for Fund Units at the option of the holder Canadian Forest Products Ltd. (Canfor). Any issuance of new Fund units as a result of such an exchange would be accompanied by a corresponding increase in the Fund's investment in the Partnership through the acquisition of Class B Exchangeable Limited Partnership Units. As a result, this potential conversion would not result in any dilution of the Fund's net income per unit.

INCOME TAXES

The Fund is a unit trust for income tax purposes. As such, the Fund only has current taxes on any taxable income not allocated to the unitholders. For the 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 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.

3. 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 Fund has incorporated this amendment into these audited consolidated financial statements.

4. EQUITY INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

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

(thousands of dollars)	Year ended December 31, 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

5. DISTRIBUTIONS

The Fund declared distributions during the twelve months of 2009 as follows:

(thousands of dollars, except per unit amounts)

Record Date	Payable Date	Amount per Fund Unit $	Amount $
January 30, 2009	February 13, 2009	0.04	1,420
February 27, 2009	March 13, 2009	0.01	355
March 31, 2009	April 15, 2009	0.01	355
April 30, 2009	May 15, 2009	0.01	355
May 29, 2009	June 15, 2009	0.01	355
June 30, 2009	July 15, 2009	0.01	355
July 31, 2009	August 14, 2009	0.01	355
August 31, 2009	September 15, 2009	0.01	355
September 30, 2009	October 15, 2009	0.01	355
October 30, 2009	November 13, 2009	0.01	355
November 30, 2009	December 15, 2009	0.05	1,775
December 31, 2009	January 15, 2010	0.08	2,839
		0.26	9,229

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

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

6. RELATED PARTY TRANSACTIONS

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf, 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. For the year ended December 31, 2008 distributions earned were $48.3 million of which $46.9 million was received, with the balance of $1.4 million receivable on December 31, 2008.

7. FUTURE INCOME TAXES

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

(thousands of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Expected income tax expense at statutory tax rate of nil (2008 – nil)	$ –	$ –
Future income taxes (recovery) on temporary differences	(2,422)	3,076
	$ (2,422)	$ 3,076

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

(thousands of dollars)	December 31, 2009	December 31, 2008
Future income tax liability:		
Equity investment in the Partnership	$ 42,347	$ 44,453
Expected reversal of temporary differences prior to 2011	(5,060)	(4,744)
	$ 37,287	$ 39,709

In 2009 a future income tax recovery of $3.7 million was recorded as a result of a change in legislation impacting future taxation rates for Specified Investment Flow Through Trusts.

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

8. ACCUMULATED OTHER COMPREHENSIVE INCOME

(thousands of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Balance, beginning of year	$ 77	$ 270
Other comprehensive loss	(45)	(193)
Balance, end of year	$ 32	$ 77

9. CAPITAL DISCLOSURES

The Fund's capital is comprised of unitholders' equity and accumulated earnings and distributions. The Fund's only source of liquidity is distributions received from the Partnership. The Fund's objective when managing capital is to make its own distributions to unitholders based on the distributions received from the Partnership.

(thousands of dollars)	December 31, 2009	December 31, 2008
Unitholders' equity[1]	$ 226,325	$ 226,488

(1) Excludes accumulated other comprehensive income.

The Fund has no external capital requirements or covenants.

10. FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of distributions receivable from the Partnership and distributions payable to unitholders. Distributions receivable are classified as loans and receivables, and are measured at amortized cost. Distributions payable are classified as other liabilities and are measured at amortized cost. The carrying values of these financial instruments approximate their fair values due to the relatively short period to maturity of these instruments.

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 is not required to disclose fair value hierarchy levels for distributions receivable from the Partnership and distributions payable to unitholders, as the fair values of these financial instruments approximate the carrying value due to their short–term nature.

The Fund is exposed to certain risks related to the nature of its investment in the Partnership and the structure of the Fund, as well as the underlying risks related to the business of the Partnership. The Fund relies on the objectives, policies and processes of the Partnership for managing these risks.

11. SEGMENTED INFORMATION

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

Canfor Pulp Limited Partnership Consolidated Financial Statements

Audit Opinion

TO THE PARTNERS OF CANFOR PULP LIMITED PARTNERSHIP

We have audited the consolidated balance sheets of Canfor Pulp Limited Partnership (the "Partnership") as at December 31, 2009 and December 31, 2008, and the consolidated statements of income, comprehensive income and Partners' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2009 and December 31, 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Vancouver, BC

February 05, 2010

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

(millions of dollars, except units and per unit amounts)	Year ended December 31, 2009	Year ended December 31, 2008
Revenue		
Sales	$ 813.5	$ 825.5
Business interruption insurance (note 19)	3.2	19.1
	816.7	844.6
Costs and expenses		
Manufacturing and product costs	$ 611.2	$ 595.8
Freight and other distribution costs	121.1	108.8
Amortization	49.4	47.6
Selling and administration costs	23.0	24.6
Settlement of asset retirement obligation (note 8)	–	(0.9)
	804.7	775.9
Operating income	$ 12.0	$ 68.7
Interest expense, net	(10.1)	(8.1)
Foreign exchange gain (loss) on long-term debt	19.6	(26.0)
Loss on derivative financial instruments (note 14)	(1.5)	(8.9)
Foreign exchange gain (loss) on working capital	(6.7)	13.1
Net property damage insurance gain	0.2	8.2
Other expense	(0.1)	(0.2)
	1.4	(21.9)
Net income	$ 13.4	$ 46.8
Other comprehensive income		
Adjustment for derivatives (note 17)	(0.1)	(0.4)
Comprehensive income	$ 13.3	$ 46.4
Net income per Partnership unit (note 13)		
Basic and diluted	$ 0.19	$ 0.66
Weighted average Partnership units outstanding	71,270,025	71,270,025
Partners' Equity		
Balance, beginning of year	$ 534.4	$ 584.9
Net income	13.4	46.8
Distributions declared to partners (note 16)	(18.6)	(96.9)
Other comprehensive loss (note 17)	(0.1)	(0.4)
Balance, end of year	$ 529.1	$ 534.4

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

Canfor Pulp Limited Partnership
Consolidated Statements of Cash Flows

(millions of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Cash and cash equivalents generated from (used in)		
Operating activities		
Net income	$ 13.4	$ 46.8
Items not affecting cash:		
Amortization	49.4	47.6
Foreign exchange loss (gain) on long-term debt	(19.6)	26.0
Reduction (increase) in value of derivative instruments	(2.1)	1.1
Employee future benefits	5.2	8.4
Loss on disposal of fixed assets	0.2	1.2
Settlement of asset retirement obligation	–	(0.9)
Change in deferred maintenance provision	5.9	9.2
Net property damage insurance gain	(0.2)	(8.2)
Other	0.4	0.6
Asset retirement obligation expenditures	–	(1.4)
Salary pension plan contribution	(2.5)	(2.1)
Long-term deferred maintenance expenditure	(10.5)	(8.7)
Other deferred expenditure	(0.2)	–
Cash flow from operations before working capital changes	39.4	119.6
Decrease (increase) in non-cash working capital (note 15)	31.8	(14.4)
	71.2	105.2
Financing activities		
Distributions paid to partners	$ (15.7)	$ (102.7)
Operating loan (repayment) draw (note 9)	(25.2)	25.2
	(40.9)	(77.5)
Investing activities		
Property, plant and equipment, net (note 15)	$ (17.3)	$ (39.4)
Insurance proceeds (note 19)	0.1	9.5
	(17.2)	(29.9)
Increase (decrease) in cash and cash equivalents	$ 13.1	$ (2.2)
Cash and cash equivalents, beginning of year	0.4	2.6
Cash and cash equivalents, end of year	$ 13.5	$ 0.4

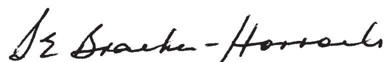
Supplementary cash flow information (note 15).
The accompanying notes are an integral part of these consolidated financial statements.

Canfor Pulp Limited Partnership
Consolidated Balance Sheets

(millions of dollars)	As at December 31, 2009	As at December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 13.5	$ 0.4
Accounts receivable (notes 12, 19)		
Trade	110.5	77.0
Insurance	–	7.4
Other	8.6	7.5
Inventories (note 4)	135.4	176.7
Prepaid expenses and other assets	18.4	16.5
Total current assets	286.4	285.5
Property, plant and equipment (note 5)	534.1	570.2
Other long-term assets (note 6)	17.1	13.2
	$ 837.6	$ 868.9
LIABILITIES		
Current liabilities		
Operating loan (note 9)	–	25.2
Accounts payable and accrued liabilities (note 12)	134.5	121.6
Distributions payable (note 16)	5.7	2.8
Total current liabilities	140.2	149.6
Long-term debt (note 9)	115.1	134.7
Long-term liabilities (note 10)	53.2	50.2
	$ 308.5	$ 334.5
PARTNERS' EQUITY – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (note 1)	529.1	534.4
	$ 837.6	$ 868.9

Commitments and contingencies (note 18).
The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of Canfor Pulp Limited Partnership by its general partner, Canfor Pulp Holding Inc.



Stan Bracken-Horrocks
Director

Paul Richards
Director

Canfor Pulp Limited Partnership – Notes to the Consolidated Financial Statements as at December 31, 2009 and 2008

1. BUSINESS DESCRIPTION AND BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

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

At December 31, 2009, 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.

These audited 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 63% (2008 – 64%) of its fibre supply as well as to provide certain key business and administrative services as described in note 12. As a result of these relationships the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

These audited consolidated financial statements include the accounts of the Partnership, its wholly-owned subsidiaries and its 50% interests in Premium One Papers (a general partnership) and Canfor April Corporation (a joint venture). The 50% interests in the general partnership and joint venture are accounted for using proportionate consolidation. All significant inter-company transactions have been eliminated.

USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. It is reasonably possible that circumstances may arise that cause actual results to differ from management estimates, however, management does not believe it is likely that such differences will materially affect the Partnership's financial position.

Significant areas requiring the use of management estimates are inventory valuations, amortization rates, employee benefit plan assumptions, asset retirement obligations, impairment of long-lived assets, provisions for insurance claims and environmental remediation.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand and highly liquid investments with an original maturity date of 90 days or less.

VALUATION OF INVENTORIES

Inventories of pulp and paper products, wood chips, and processing materials and supplies are valued at the lower of average cost and net realizable value.

PROPERTY, PLANT AND EQUIPMENT

The Partnership capitalizes the costs of major replacements, extensions, and improvements to plant and equipment.

Assets are amortized over the following estimated productive lives:

Buildings	10 to 50 years
Pulp and paper machinery and equipment	20 years

Amortization of manufacturing assets is calculated on a straight-line basis. Assets under construction are not amortized.

EMPLOYEE FUTURE BENEFITS

The Partnership provides certain pension, health care benefits and pension bridge plans to eligible retired employees.

The Partnership accrues the costs and related obligations of the defined benefit salary pension plans, the pension bridge plan and other retirement benefit plans using the projected benefit actuarial method prorated on service and management's best estimates of salary escalation and other relevant factors. Actuarial gains and losses arise from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees, which is 10 years for the salary pension plan, 11 years for the pension bridge plan and 11 years for the other benefit plans. Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. On January 1, 2000, the Pulp Business (Canfor) adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to the accounting for pensions and other post-employment benefits using the prospective application method. The Partnership is amortizing the transitional obligation on a straight-line basis over 16 years, which was the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

For hourly employees covered by industry union defined benefit pension plans, earnings are charged with the Partnership's contributions required under the collective agreements.

REVENUE RECOGNITION

Revenues are derived from the following major product lines: pulp, paper and sales commissions. Revenue is recognized from product sales when persuasive evidence of a sale exists, the sales price is fixed and determinable, goods have been delivered or title has transferred, and collectability is reasonably assured. Sales are reported net of discounts, allowances and vendor rebates. Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by the Partnership are reported as cost of sales.

FOREIGN CURRENCY TRANSLATION

The majority of sales are denominated in foreign currencies. Foreign currencies are translated into Canadian dollars using the temporal method as follows: monetary assets and liabilities at period end exchange rates; and revenues and expenses at exchange rates prevailing at the time the transaction occurs. Exchange gains and losses are reflected in income as incurred.

DERIVATIVE FINANCIAL INSTRUMENTS

The Partnership utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange and commodity price risk. For example, from time to time, it purchases foreign exchange forward sales contracts to hedge related foreign currency denominated accounts receivable balances and also enters into swap transactions to reduce its exposure to fluctuating natural gas prices. The Partnership records all derivatives at fair value and its policy is not to utilize derivative financial instruments for trading or speculative purposes.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment when the occurrence of events or changes in circumstances indicate that the carrying value of the assets may not be recoverable, as measured by comparing their net book value to the estimated future cash flows generated over their estimated remaining useful lives. Impaired assets are recorded at fair value, determined principally using discounted future cash flows expected from their use and eventual disposition.

INCOME TAXES

The Partnership is not directly subject to federal or provincial income taxes. The taxable income or loss of the Partnership is required to be allocated to the Partnership's partners. Management is of the opinion that any income tax liability arising from the activities of the wholly-owned subsidiaries will not be material.

MAJOR MAINTENANCE COSTS

The Partnership has adopted the deferral method of accounting for major maintenance costs. Under this method an asset is recorded when expenditures for maintenance costs related to major maintenance are incurred. This asset is then amortized over the period to which the maintenance relates. The Partnership has presented the related unamortized expenditures in prepaid expense and other assets, and other long-term assets, as appropriate.

3. 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 these audited consolidated financial statements.

4. INVENTORIES

(millions of dollars)	December 31, 2009	December 31, 2008
Pulp	$ 55.2	$ 86.7
Paper	15.9	20.6
Wood chips	21.5	23.3
Processing materials and supplies	42.8	46.1
	$ 135.4	$ 176.7

Paper finished goods inventory balances at December 31, 2009 are presented net of a write-down from cost to net realizable value totalling $0.1 million (2008 pulp and paper – $1.9 million).

5. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	December 31, 2009 Cost	Accumulated amortization	Net
Land and improvements	$ 5.4	$ –	$ 5.4
Asset retirement - landfill	2.3	0.8	1.5
Buildings, machinery and equipment	1,344.1	820.1	524.0
Construction in progress	3.2	–	3.2
	$ 1,355.0	$ 820.9	$ 534.1

(millions of dollars)	December 31, 2008 Cost	Accumulated amortization	Net
Land and improvements	$ 5.4	$ –	$ 5.4
Asset retirement - landfill	2.3	0.8	1.5
Buildings, machinery and equipment	1,332.6	771.7	560.9
Construction in progress	2.4	–	2.4
	$ 1,342.7	$ 772.5	$ 570.2

6. OTHER LONG-TERM ASSETS

(millions of dollars)	December 31, 2009	December 31, 2008
Pension benefit plan (note 7)	$ 11.3	$ 11.7
Maintenance shutdown costs	5.4	0.9
Other	0.4	0.6
	$ 17.1	$ 13.2

7. EMPLOYEE FUTURE BENEFITS

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

Total employee future benefit expenses were as follows:

(millions of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Pension plans	$ 5.0	$ 3.7
Other employee future benefit plans	3.5	6.0
Contributions to forest industry union plans	6.5	6.3
	$ 15.0	$ 16.0

DEFINED BENEFIT PLANS

The measurement date for the determination of accrued benefit obligations and the fair value of plan assets for the employee future benefit plans is September 30, 2009. The most recent actuarial valuation for funding purposes for the Canfor salaried employees' pension plans in which the Partnership's employees participate was on December 31, 2006. The most recent actuarial valuations for the other post retirement benefit plan and the Pension Bridge Plan were on September 30, 2007 and December 31, 2006, respectively.

The next actuarial valuation for funding purposes for the registered salaried employee defined benefit pension plan is currently in progress and scheduled to be completed in 2010 with an effective date of December 31, 2009. Changes in the fair value of plan assets and actuarial assumptions, as appropriate to reflect prevailing financial market conditions at that time, including assumed rate of return on plan assets, discount rates and other variables, will be reflected in the December 31, 2009 valuation and will determine funding requirements for 2010 and subsequent years.

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

Defined Benefit Plan Assets

	2009		2008	
(millions of dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets				
Beginning of year	$ 51.0	$ –	$ 58.1	$ –
Actual return on plan assets	0.1	–	(8.7)	–
Employer contributions	3.0	1.0	2.6	0.8
Employee contributions	0.3	–	0.3	–
Benefit payments	(1.7)	(1.0)	(1.3)	(0.8)
End of year	$ 52.7	$ –	$ 51.0	$ –

	Percentage of Plan Assets	
	2009	2008
Plan assets consist of the following:		
Equity securities	58%	61%
Debt securities	41%	38%
Other	1%	1%
	100%	100%

Defined Benefit Plan Obligations

	2009		2008	
(millions of dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Accrued benefit obligation				
Beginning of year	$ 60.5	$ 37.1	$ 65.1	$ 56.8
Current service cost	2.9	0.7	3.8	1.3
Interest cost	4.0	2.5	3.7	3.2
Employee contributions	0.3	–	0.3	–
Benefit payments	(1.7)	(1.0)	(1.3)	(0.8)
Plan amendments	–	–	1.0	–
Actuarial loss (gain)	2.4	5.0	(12.1)	(23.4)
End of year	$ 68.4	$ 44.3	$ 60.5	$ 37.1

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

(millions of dollars)	2009 Pension Benefit Plans	2009 Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Fair market value of plan assets	$ 52.7	$ –	$ 51.0	$ –
Accrued benefit obligation	68.4	44.3	60.5	37.1
Funded status of plans – deficit	(15.7)	(44.3)	(9.5)	(37.1)
Employer contributions after measurement date	0.8	0.3	0.8	0.2
Unamortized transitional obligation (asset)	(0.8)	4.7	(0.8)	5.5
Unamortized past service costs	2.2	–	2.4	–
Unamortized net actuarial loss (gain)	18.2	(3.9)	12.9	(9.4)
Accrued benefit asset (liability)	$ 4.7	$ (43.2)	$ 5.8	$ (40.8)
The accrued benefit asset (liability) is included in the Partnership's balance sheet as follows:				
Other long-term assets (note 6)	$ 11.3	$ –	$ 11.7	$ –
Accounts payable and accrued liabilties	(0.8)	–	–	–
Long-term liabilities (note 10)	(5.8)	(43.2)	(5.9)	(40.8)
	$ 4.7	$ (43.2)	$ 5.8	$ (40.8)

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

(millions of dollars)	2009 Pension Benefit Plans	2009 Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Fair market value of plan assets	$ 52.7	$ –	$ 0.3	$ –
Accrued benefit obligation	(68.4)	(43.2)	(10.7)	(40.8)
Funded status - plan deficit	$ (15.7)	$ (43.2)	$ (10.4)	$ (40.8)

Included in the $15.7 million pension plan deficit noted above, is $11.3 million relating to the Pension Bridge Plan and other pension plans, for which no funding obligation is required (2008 – $10.4 million).

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

(millions of dollars)	2009 Incurred in Year	2009 Matching Adjustments[1]	2009 Recognized in Year	2008 Incurred in Year	2008 Matching Adjustments[1]	2008 Recognized in Year
Defined Benefit Pension Plans						
Current service cost, net of employee contributions	$ 2.9	$ –	$ 2.9	$ 3.8	$ -	$ 3.8
Interest cost	4.0	–	4.0	3.7	–	3.7
Return on plan assets	(0.1)	(3.8)	(3.9)	8.7	(13.1)	(4.4)
Actuarial loss (gain)	2.4	(1.4)	1.0	(12.1)	12.6	0.5
Plan amendments	–	0.2	0.2	1.0	(0.9)	0.1
Amortization of transitional obligation	–	(0.1)	(0.1)	–	(0.1)	(0.1)
	$ 9.2	$ (5.1)	$ 4.1	$ 5.1	$ (1.5)	$ 3.6
Other Benefit Plans						
Current service cost, net of employee contributions	$ 0.7	$ –	$ 0.7	$ 1.2	$ -	$ 1.2
Interest cost	2.5	–	2.5	3.2	–	3.2
Actuarial loss (gain)	5.0	(5.6)	(0.6)	(23.4)	24.2	0.8
Amortization of transitional obligation	–	0.8	0.8	–	0.8	0.8
	$ 8.2	$ (4.8)	$ 3.4	$ (19.0)	$ 25.0	$ 6.0

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

SIGNIFICANT ASSUMPTIONS

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

(weighted average assumptions)	2009 Pension Benefit Plans	2009 Other Benefit Plans	2008 Pension Benefit Plans	2008 Other Benefit Plans
Accrued benefit obligation as of December 31:				
Discount rate	6.25%	6.75%	6.60 %	6.70 %
Rate of compensation increase	3.0%	n/a	3.0 %	n/a
Benefit costs for year ended December 31:				
Discount rate	6.60%	6.70%	5.60 %	5.50 %
Expected long-term rate of return on plan assets	7.5%	n/a	7.5 %	n/a
Rate of compensation increase	3.0%	n/a	3.0 %	n/a

Assumed health care cost trend rates

(weighted average assumptions)	2009	2008
Initial health care cost trend rate	7.40%	5.67%
Ultimate health care trend rate	4.10%	4.22%
Year ultimate rate is reached	2029	2014

SENSITIVITY ANALYSIS

Assumed health care cost trend rates have a significant effect on the amounts reported for the other benefit plans. A one percentage point change in assumed health care cost trend rates would have the following effects for 2009:

(millions of dollars)	1% Increase	1% Decrease
Accrued benefit obligation	$ 8.3	$ (6.7)
Total of service and interest cost	$ 0.7	$ (0.5)

8. ASSET RETIREMENT OBLIGATIONS

(millions of dollars)	December 31, 2009	December 31, 2008
Balance beginning of year	$ 2.8	$ 11.3
Accretion expense	0.2	0.4
Current expenditures	–	(1.2)
Gain on settlement	–	(0.9)
Change in estimate	–	(6.8)
Balance end of year	$ 3.0	$ 2.8

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.

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

9. CREDIT FACILITIES AND LONG-TERM DEBT

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

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 Electricity 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. The effective interest rate on the bank credit facility for the year ended December 31, 2009 was 2.9%.

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.

The fair value of long-term debt at December 31, 2009 was $120.9 million (US$115.6 million).

10. LONG-TERM LIABILITIES

(millions of dollars)	December 31, 2009	December 31, 2008
Accrued pension obligations (note 7)	$ 5.8	$ 5.9
Post-employment benefits (note 7)	43.2	40.8
Derivative financial instruments (note 14)	1.2	0.7
Asset retirement obligations (note 8)	3.0	2.8
	$ 53.2	$ 50.2

11. CAPITAL DISCLOSURES

The Partnership's objectives when managing capital are to safeguard its assets and maintain a globally competitive cost structure, continue as a going concern and provide returns to its partners in the form of distributions and capital appreciation. In addition, the Partnership works with relevant stakeholders to ensure the safety of its operations and employees, and to remain in compliance with all environmental regulations.

The Partnership's capital is comprised of net debt and Partners' equity:

(millions of dollars)	December 31, 2009	December 31, 2008
Total debt	$ 115.1	$ 159.9
Cash and cash equivalents	(13.5)	(0.4)
Net debt	101.6	159.5
Total Partners' equity[1]	529.1	534.3
	$ 630.7	$ 693.8

(1) Excludes accumulated other comprehensive income – note 17.

Management 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, less actual capital expenditures. 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 non-cash working capital will be funded from cash resources or the revolving short-term credit facility, and thus will not significantly affect the level of distributions.

The Partnership believes its objectives for managing capital in the current economic environment are still appropriate.

The Partnership's long-term debt and short-term credit facility agreements contain leverage and interest ratio covenants, as described in note 9.

12. 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 were 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), which were 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), which were 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 Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, 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 Canfor's Taylor Pulp Mill, 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.

13. NET INCOME PER PARTNERSHIP UNIT

Basic net income per Partnership unit is based on the weighted average number of Limited Partnership units outstanding during the year. All outstanding Partnership units were issued on July 1, 2006, and there was no change in the number of outstanding Partnership units during the year.

14. FINANCIAL INSTRUMENTS

CLASSIFICATION OF FINANCIAL INSTRUMENTS

The Partnership has classified its cash and cash equivalents as held-for-trading. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Accounts payable and accrued liabilities, distributions payable, operating loan 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. The Partnership has no derivatives embedded in its financial or non-financial contracts that are not closely related to the host contract.

FINANCIAL RISK MANAGEMENT

The Partnership is exposed to a number of risks as a result of holding financial instruments. These risks include credit risk, liquidity risk and market risk.

Risk management is carried out by the risk management committee under a "Risk Management Controls Policy". The policy sets out the responsibilities, reporting and counter party credit and communication requirements associated with all of the Partnership's risk management activity. Responsibility for overall philosophy, direction and approval is that of the Board of Directors.

I) CREDIT RISK:

Credit risk is the risk of financial loss to the Partnership if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments that potentially subject the Partnership to credit risk include cash and cash equivalents, accounts receivable and derivatives.

In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The Partnership does not have holdings in asset-backed commercial paper. The cash and cash equivalents balance at December 31, 2009 was $13.5 million. The Partnership does not believe there is any significant credit risk associated with cash on deposit held in major Canadian and international financial institutions.

The Partnership utilizes a combination of credit insurance and self-insurance to manage the risk associated with trade receivables. Approximately 81% of the outstanding trade receivables are covered under credit insurance. In addition, the Partnership requires letters of credit on certain export trade receivables and periodically discounts these letters of credit without recourse. The Partnership recognizes the sale of the letters of credit on the settlement date, and accordingly reduces the related trade accounts receivable balance. At December 31, 2009, the Partnership had reduced the trade accounts receivable balance by $11.9 million due to discounting of letters of credit. The Partnership's trade receivable balance at December 31, 2009 was $110.5 million. The Partnership believes that its approach to managing credit risk associated with the collection of outstanding trade accounts receivable is appropriate in the current credit market.

The Partnership does not believe that there is any significant counter party credit risk in respect of outstanding derivatives.

2) LIQUIDITY RISK:

Liquidity risk is the risk that the Partnership will be unable to meet its financial obligations as they fall due. The Partnership manages liquidity risk through management of its capital structure in conjunction with cash flow forecasting including anticipated investing and financing activities, and use of 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 amounts periodically to manage cash resources. In addition, the Partnership is utilizing discounting of letters of credit on outstanding trade receivables to manage liquidity risk. At December 31, 2009, the impact of discounting of letters of credit accelerated cash collection and reduced the trade accounts receivable balance by $11.9 million. The Partnership believes it will be able to meet all of its financial obligations as they become due.

At December 31, 2009, the Partnership's accounts payable and accrued liabilities totalled $134.5 million, all of which fall due for payment within one year of the balance sheet date. The Partnership's distributions payable at December 31, 2009 totalled $5.7 million, which fall due for payment on January 15, 2010.

3) MARKET RISK:

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates, foreign currency and commodity prices.

A. INTEREST RATE RISK:

The Partnership is exposed to interest rate risk through its financial assets and financial obligations bearing variable interest rates and through its off-balance sheet lease obligations.

The Partnership manages interest rate risk by maximizing the interest earned on excess funds while maintaining the liquidity necessary to meet day-to-day operating cash flow requirements and payment of monthly declared distributions to unitholders.

Fluctuations in market interest rates are not expected to have a material impact on the Partnership's results of operations due to the short-term nature of the respective financial assets and obligations and the fixed interest rate on long-term debt.

The Partnership currently does not use derivative instruments to reduce its exposure to interest rate risk.

B. CURRENCY RISK:

The Partnership is exposed to foreign exchange risk. The Partnership's products are sold globally with prices primarily denominated in US dollars or linked to prices quoted in US dollars with certain expenditures transacted in US dollars. In addition the Partnership holds financial assets and liabilities in US dollars. These primarily include US dollar bank accounts and investments, trade accounts receivable and long-term debt.

The Partnership enters into US dollar forward sales contracts to reduce exposure to fluctuations in US exchange rates on US dollar denominated accounts receivable and accounts payable balances.

C. COMMODITY PRICE RISK:

The Partnership's financial performance is dependent on the selling price of its products and the purchase price of raw material inputs. Consequently, the Partnership is exposed to changes in commodity prices for pulp and paper, as well as changes in fibre, freight, chemical and natural gas prices. The markets for pulp and paper are cyclical and are influenced by a variety of factors. These factors include periods of excess supply due to industry capacity additions, periods of decreased demand due to weak global economic activity, inventory destocking by customers and fluctuations in currency exchange rates. During periods of low prices, the Partnership is subject to reduced revenues and margins, which adversely impact profitability.

The Partnership may periodically use derivative instruments to mitigate commodity price risk. For the year ended December 31, 2009 the Partnership used derivative instruments to reduce exposure to natural gas prices.

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

FAIR VALUE HIERARCHY

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 following table sets forth the carrying value and the fair value of the Partnership's financial assets and liabilities. The table also identifies the levels per the fair value hierarchy where fair value is recognized in the balance sheet.

	As at December 31, 2009		
(millions of dollars)	Carrying Value	Fair Value	Fair Value Hierarchy Level
Financial assets:			
Cash and cash equivalents[1]	$ 13.5	$ 13.5	1
Accounts receivable[1]	118.0	118.0	2
Derivative assets[2]	1.1	1.1	2
Financial liabilities:			
Account payable and accrued liabilities[1]	$ 132.2	$ 132.2	2
Distributions payable[1]	5.7	5.7	2
Long-term debt[3]	115.1	120.9	n/a
Derivative liabilities[2]	3.5	3.5	2

(1) Fair value approximates carrying value due to the short-term nature of these instruments.
(2) The fair value of derivative instruments is based on quoted market prices for comparable contracts and represents the amount the Partnership would have received from, or paid to, a counterparty to unwind the contract at the market rates in effect at the balance sheet dates and therefore derivative instruments are classified within Level 2 of the fair value hierarchy established by section 3862. Derivative assets are recorded in other accounts receivable and derivative liabilities are recorded in accounts payable and accrued liabilities and in long-term liabilities in the consolidated balance sheet.
(3) Recorded at amortized cost.

DERIVATIVE INSTRUMENTS

Periodically, the Partnership uses derivative instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, pulp 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 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 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 is 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 is recorded as an asset in other accounts receivable.

15. SUPPLEMENTARY CASH FLOW INFORMATION

(millions of dollars)	Year ended December 31 2009	Year ended December 31 2008
Decrease (increase) in non-cash working capital		
Accounts receivable – trade and other	$ (33.4)	$ 71.0
Insurance receivable	7.3	(7.5)
Inventories	41.3	(46.7)
Prepaid expenses and other assets	(1.8)	(0.9)
Accounts payable and accrued liabilities	18.4	(30.3)
	$ 31.8	$ (14.4)
Capital expenditures		
Capital expenditures - cash	$ 17.3	$ 39.4
Less property damage insurance proceeds	–	(9.4)
Net capital expenditures - cash	17.3	30.0
Capital expenditures accruals – net	(3.8)	(4.7)
Change in asset retirement obligations – long-term	–	(6.8)
	13.5	18.5
Net interest paid	$ 9.0	$ 8.1

16. DISTRIBUTIONS

The Partnership declared distributions in the twelve months of 2009 as follows:

(millions of dollars, except per unit amounts)

Record Date	Payable Date	Amount per Partnership Unit $	Amount $
January 30, 2009	February 13, 2009	0.04	2.9
February 27, 2009	March 13, 2009	0.01	0.7
March 31, 2009	April 15, 2009	0.01	0.7
April 30, 2009	May 15, 2009	0.01	0.7
May 29, 2009	June 15, 2009	0.01	0.7
June 30, 2009	July 15, 2009	0.01	0.7
July 31, 2009	August 14, 2009	0.01	0.8
August 31, 2009	September 15, 2009	0.01	0.7
September 30, 2009	October 15, 2009	0.01	0.7
October 30, 2009	November 13, 2009	0.01	0.7
November 30, 2009	December 15, 2009	0.05	3.6
December 31, 2009	January 15, 2010	0.08	5.7
		0.26	18.6

17. ACCUMULATED OTHER COMPREHENSIVE INCOME

(millions of dollars)	Year ended December 31, 2009	Year ended December 31, 2008
Balance, beginning of year	$ 0.1	$ 0.5
Adjustment for exchange translation	(0.2)	0.2
Adjustment for derivatives recoded in other comprehensive income (loss)	0.1	(0.6)
Balance, end of year	$ –	$ 0.1

Since the inception of the Partnership, the total of the cumulative comprehensive income, less cumulative distributions is as follows:

(millions of dollars)	December 31, 2009
Cumulative comprehensive income	$ 276.7
Cumulative distributions	(335.1)
	(58.4)
Partners' capital – at July 1, 2006	587.5
Partners' equity, end of year	$ 529.1

18. COMMITMENTS AND CONTINGENCIES

The Partnership has committed to the following operating leases for property, plant and equipment. As 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

The Partnership finalized an amending Electricity Purchase 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, is reduced to 338 GWh per year from 390 GWh effective September 15, 2009. Under the amended Cogeneration Agreement with BC Hydro, if the cogeneration project generates less than the amended commitment in any year and the shortfall cannot be made up by excess generation in prior years or excess generation in the subsequent year, the Partnership is required to pay BC Hydro an amount equal to the uncorrected shortfall as a ratio of the annual requirement. 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 is generated. As of December 31, 2009, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount $16.0 million has been issued to BC Hydro.

19. PRINCE GEORGE PULP AND PAPER MILL FIRE AND INSURANCE

During 2009, the Partnership reached a final settlement with the insurers of the claim from the Prince George Pulp and Paper Mill fire in 2008. Total business interruption insurance accrued and received was $25.6 million, which is net of a 3-day equivalent deductible of $1.0 million. Total business interruption insurance recorded in 2009 was $3.5 million, with $3.2 million recorded as revenue and $0.3 million recorded as a credit to manufacturing and product costs.

Total property damage insurance accrued and received was $12.4 million, which is net of aggregate policy deductibles of $3.25 million. Total property damage insurance proceeds recorded as a non-operating gain in 2009 were $0.2 million.

Final payment received in 2009 was $11.0 million, of which $9.8 million related to final settlement of the business interruption insurance claim and $1.2 million for property damage, of which $0.1 million has been classified as an investing activity on the cash flow statement, with the balance of $1.1 million representing demolition costs.

20. 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 has been 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 has 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.

21. SEGMENTED INFORMATION[a]

(millions of dollars)		Pulp		Paper		Unallocated Costs		Total
Year ended December 31, 2009								
Sales to external customers[b]	$	690.0	$	122.5	$	1.0	$	813.5
Sales of pulp to paper segment[c]		63.7		(63.7)		–		–
Operating income (loss)		11.7		10.6		(10.3)		12.0
Amortization		45.9		3.3		0.2		49.4
Capital expenditures, net		13.2		0.1		0.2		13.5
Identifiable assets	$	739.3	$	64.4	$	33.9	$	837.6
Year ended December 31, 2008								
Sales to external customers[b]	$	695.2	$	130.3	$	–	$	825.5
Sales of pulp to paper segment[c]		78.7		(78.7)		–		–
Operating income (loss)		72.5		9.4		(13.2)		68.7
Amortization		43.7		3.7		0.2		47.6
Capital expenditures, net		26.7		0.4		0.8		27.9
Identifiable assets	$	772.6	$	73.9	$	22.4	$	868.9

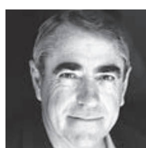
(a) Operations are presented by product lines. Operations are considered to be in one geographic area since all production facilities are in Canada. Substantially all sales are exported outside Canada, with sales to the United States representing 36% (2008 – 43%).
(b) Sales to the largest customer represented approximately 7% of pulp segment sales (2008 – 12%).
(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.

Trustees and Directors, Officers and Management Team

TRUSTEES AND DIRECTORS

Charles J. Jago, Ph.D., C.M.[1][2][3][4]
Trustee and Director
Chairman, Canfor Pulp Holding Inc.
Prince George, British Columbia

Peter J.G. Bentley, LL.D., O.C.[3][4]
Director
Chairman Emeritus of the Board
Canfor Corporation
Vancouver, British Columbia



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President and Chief Executive Officer
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President and Chief Executive Officer
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Vancouver, British Columbia

William W. Stinson[1][3][4]
Director
Chairman and Chief Executive Officer
Westshore Terminals Income Fund
Vancouver, British Columbia

(1) Member of Audit Committee for the Fund and the General Partner.
(2) Member of the Governance Committee.
(3) Member of the Compensation Committee.
(4) Member of the Planning Committee.

OFFICERS

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West Vancouver, British Columbia

Terry D. Hodgins, CA
Chief Financial Officer and Secretary
Canfor Pulp Holding Inc.
West Vancouver, British Columbia

Joe Nemeth
Vice-President, Sales and Marketing
Canfor Pulp Holding Inc.
Langley, British Columbia

Brett R. Robinson
Vice-President, Operations
Canfor Pulp Holding Inc.
Prince George, British Columbia

MANAGEMENT TEAM

Richard Cooper
General Manager, Fibre Supply

Robert Dufresne
General Manager, Northwood Pulp Mill

Rick Pingel
General Manager, Global Logistics and Procurement

Martin Pudlas
General Manager, PGI Pulpmills and Specialty Paper

Rick Remesch, CA
Corporate Controller

David Scott
General Manager, Human Resources

COMPANY INFORMATION

Annual General Meeting
The Annual General Meeting of the holders of fund units of Canfor Pulp Income Fund (the Fund) will be held at the Terminal City Club, Terrace B Room, 837 West Hastings Street, Vancouver, British Columbia on Tuesday, April 27, 2010 at 11:30 a.m.

Transfer Agent and Registrar
CIBC Mellon Trust Company
Vancouver, Calgary, Regina, Winnipeg, Toronto, Montreal and Halifax

Stock Listing
Toronto Stock Exchange
Symbol: CFX.UN

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Canfor Pulp Income Fund also produces an Annual Information Form. To obtain this publication visit the website www.canforpulp.com

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