CANFOR PULP PRODUCTS INC.

Consolidated Financial Statements

For the years ended December 31, 2012 and 2011

MANAGEMENT'S RESPONSIBILITY

The information and representations in these consolidated financial statements are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements were prepared by management in accordance with International Financial Reporting Standards and, where necessary, reflect management's best estimates and judgments at this time. It is reasonably possible that circumstances may arise which cause actual results to differ. Management does not believe it is likely that any differences will be material.

Canfor Pulp Products Inc. maintains systems of internal accounting controls, policies and procedures to provide reasonable assurance as to the reliability of the financial records and the safeguarding of its assets.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out these activities primarily through its Audit Committee.

The Audit Committee is comprised of three Directors who are not employees of the Company. 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 and internal auditors meet separately with the Audit Committee.

The consolidated financial statements have been reviewed by the Audit Committee and approved by the Board of Directors. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the external auditors, whose report follows.

February 13, 2013

"*Don B. Kayne*"

Don B. Kayne
President and Chief Executive Officer

"*Alan Nicholl*"

Alan Nicholl
Senior Vice-President, Finance and Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Canfor Pulp Products Inc.

We have audited the accompanying consolidated financial statements of Canfor Pulp Products Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011 and the consolidated statements of income, the consolidated statements of other comprehensive income (loss), the consolidated statements of changes in equity, and the consolidated statements of cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canfor Pulp Products Inc. and its subsidiaries as at December 31, 2012 and December 31, 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

"PricewaterhouseCoopers LLP"

Chartered Accountants
Vancouver, British Columbia
February 13, 2013

Canfor Pulp Products Inc.
Consolidated Balance Sheets

(millions of Canadian dollars)		As at December 31, 2012		As at December 31, 2011 (Note 24)
ASSETS				
Current assets				
Accounts receivable - Trade	**$**	**61.6**	$	70.8
- Green Transformation Program (Note 7)		**-**		19.7
- Other (Note 20)		**22.8**		20.7
Inventories (Note 5)		**134.1**		141.6
Prepaid expenses and other assets		**8.3**		5.8
Total current assets		**226.8**		258.6
Property, plant and equipment (Note 6)		**530.8**		532.0
Other long-term assets		**0.4**		0.6
Total assets	**$**	**758.0**	$	791.2
LIABILITIES				
Current liabilities				
Cheques issued in excess of cash on hand	**$**	**1.2**	$	2.0
Accounts payable and accrued liabilities (Note 8)		**93.4**		117.9
Current portion of long-term debt (Note 10)		**109.4**		-
Distributions payable		**-**		7.8
Total current liabilities		**204.0**		127.7
Long-term debt (Note 10)		**-**		111.9
Retirement benefit obligations (Note 11)		**105.1**		94.8
Other long-term provisions		**3.6**		3.1
Deferred income taxes, net (Note 15)		**59.6**		-
Total liabilities	**$**	**372.3**	$	337.5
EQUITY				
Share capital (Note 13)	**$**	**525.3**	$	294.9
Retained earnings (deficit)		**(139.6)**		(67.3)
Non-controlling interest in the Partnership (Note 24)		**-**		226.1
Total equity	**$**	**385.7**	$	453.7
Total liabilities and equity	**$**	**758.0**	$	791.2

Subsequent Event (Note 25)

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

APPROVED BY THE BOARD

"S.E. Bracken-Horrocks" *"R.L. Cliff"*

Director, S.E. Bracken-Horrocks Director, R.L. Cliff

Canfor Pulp Products Inc.
Consolidated Statements of Income

(millions of Canadian dollars, except per share data)	Year ended December 31, **2012**	2011
Sales (Note 20)	**$ 810.4**	$ 941.0
Costs and expenses		
Manufacturing and product costs (Note 20)	**576.0**	579.5
Freight and other distribution costs	**116.4**	116.0
Amortization	**67.1**	66.8
Selling and administration costs	**24.6**	25.3
Restructuring and severance costs	**1.7**	-
	785.8	787.6
Operating income	**24.6**	153.4
Finance expense, net (Note 14)	**(11.8)**	(10.9)
Foreign exchange gain (loss) on long-term debt	**2.4**	(2.5)
Gain (loss) on derivative financial instruments (Note 23)	**1.7**	(1.6)
Foreign exchange gain (loss) on working capital	**(1.2)**	1.0
Net income before income taxes	**15.7**	139.4
Income tax expense (Note 15)	**(2.0)**	(0.8)
Net income	**$ 13.7**	$ 138.6
Net income attributable to:		
Controlling interest in the Partnership	**$ 9.4**	$ 69.7
Non-controlling interest in the Partnership (Note 24)	**4.3**	68.9
Net income	**$ 13.7**	$ 138.6
Net income per common share: (in dollars)		
Attributable to controlling interest in the Partnership		
- Basic and diluted (Note 16)	**$ 0.14**	$ 1.94

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

Canfor Pulp Products Inc.
Consolidated Statements of Other Comprehensive Income (Loss)

(millions of Canadian dollars)	Year ended December 31, 2012	2011
Net income	**$ 13.7**	$ 138.6
Other comprehensive income (loss)		
Defined benefit plan actuarial losses	**(16.6)**	(17.7)
Income tax recovery on defined benefit plan actuarial losses (Note 15)	**4.1**	-
Other comprehensive income (loss), net of tax	**(12.5)**	(17.7)
Total comprehensive income	**$ 1.2**	$ 120.9
Total comprehensive income (loss) attributable to:		
Controlling interest in the Partnership	**$ (3.1)**	$ 60.8
Non-controlling interest in the Partnership (Note 24)	**4.3**	60.1
Total comprehensive income	**$ 1.2**	$ 120.9

Consolidated Statements of Changes in Equity

(millions of Canadian dollars)	Year ended December 31, 2012	2011
Share capital		
Balance at beginning of year	**$ 294.9**	$ 294.9
Exchange transaction (Note 24)	**230.4**	-
Balance at end of year (Note 13)	**$ 525.3**	$ 294.9
Retained earnings (deficit)		
Balance at beginning of year	**$ (67.3)**	$ (52.9)
Exchange transaction (Note 24)	**(57.8)**	-
Net income excluding amount attributable to non-controlling interests in the Partnership	**9.4**	69.7
Defined benefit plan actuarial losses excluding amount attributable to non-controlling interest in the Partnership, net of tax	**(12.5)**	(8.9)
Dividends/distributions declared excluding amounts attributable to non-controlling interest in the Partnership	**(11.4)**	(75.2)
Balance at end of year	**$ (139.6)**	$ (67.3)
Total equity attributable to equity holders of the Company	**$ 385.7**	$ 227.6
Non-controlling interest in the Partnership		
Balance at beginning of year	**$ 226.1**	$ 240.5
Net income attributable to non-controlling interests in the Partnership	**4.3**	68.9
Defined benefit plan actuarial losses attributable to non-controlling interest in the Partnership	**-**	(8.8)
Distributions to non-controlling interest in the Partnership	**-**	(74.5)
Exchange transaction (Note 24)	**(230.4)**	-
Balance at end of year	**$ -**	$ 226.1
Total equity	**$ 385.7**	$ 453.7

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

Canfor Pulp Products Inc.
Consolidated Statements of Cash Flows

(millions of Canadian dollars)		Year ended December 31, 2012		2011
Cash generated from (used in):				
Operating activities				
Net income	**$**	**13.7**	$	138.6
Items not affecting cash:				
Amortization		**67.1**		66.8
Income tax expense (Note 15)		**2.0**		0.8
Foreign exchange (gain) loss on long-term debt		**(2.4)**		2.5
Changes in mark-to-market value of derivative financial instruments		**0.4**		(1.8)
Employee future benefits		**(1.9)**		2.2
Net finance expense (Note 14)		**11.8**		10.9
Other, net		**0.3**		0.2
Salary pension plan contributions		**(7.6)**		(7.9)
Income taxes paid, net		**(7.7)**		(0.2)
Net change in non-cash working capital (Note 17)		**12.2**		(13.1)
		87.9		199.0
Financing activities				
Dividends / distributions paid		**(19.2)**		(181.0)
Finance expenses paid		**(8.1)**		(7.8)
		(27.3)		(188.8)
Investing activities				
Additions to property, plant and equipment		**(87.6)**		(68.5)
Expenditures under Green Transformation Program		**(1.1)**		(87.6)
Reimbursements under Green Transformation Program (Note 7)		**19.7**		75.6
Other government grants received		**2.2**		3.5
Acquisition of CPPI cash on exchange (Note 24)		**6.8**		-
Other, net		**0.2**		0.6
		(59.8)		(76.4)
Increase (decrease) in cash and cash equivalents*		**0.8**		(66.2)
Cash and cash equivalents at beginning of year*		**(2.0)**		64.2
Cash and cash equivalents at end of year*	**$**	**(1.2)**	$	(2.0)

*Cash and cash equivalents include cash on hand less unpresented cheques.

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

Canfor Pulp Products Inc.
Notes to the Consolidated Financial Statements

1. Reporting Entity

Canfor Pulp Products Inc. ("CPPI") is a company incorporated and domiciled in Canada and listed on the Toronto Stock Exchange. The address of the Company's registered office is 1700 – 666 Burrard Street, Vancouver, British Columbia, Canada V6C 2X8. The consolidated financial statements of the Company as at and for the year ended December 31, 2012 comprise the Company and its subsidiary entities including Canfor Pulp Limited Partnership ("the Partnership"). The Partnership's operations consist of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, British Columbia and a marketing group based in Vancouver, British Columbia ("the Pulp Business").

On March 2, 2012, Canadian Forest Products Ltd. ("Canfor") exchanged 35,776,483 Class B Exchangeable Limited Partnership Units ("the Exchange"), representing a 50.2% interest in the Partnership, for an equivalent number of CPPI shares pursuant to the terms of the exchange agreement dated January 1, 2011 between Canfor, CPPI, the Partnership and Canfor Pulp Holding Inc., the general partner of the Partnership ("the General Partner"). As a result of the Exchange, CPPI's interest in both the Partnership and the General Partner increased from 49.8% to 100% and Canfor acquired a 50.2% interest in CPPI (Note 24).

At December 31, 2012 CPPI held a 100% interest in the Partnership and the General Partner and Canfor held a 50.2% interest in CPPI.

The consolidated financial statements ("the financial statements") at December 31, 2012 include the accounts of CPPI, the Partnership and its subsidiaries (together referred to as "CPPI" or "the Company"). Prior to March 2, 2012 Canfor held a direct controlling interest in the Partnership. For all periods ending prior to March 2, 2012, the financial statements present the financial position, results of operations, and cash flows of the Pulp Business from the perspective of Canfor's controlling interest in the Pulp Business as if operated as a stand-alone partnership entity subject to Canfor control. The acquisition of the Partnership by CPPI as a result of the Exchange has been accounted for as a continuity of interests by applying reverse acquisition accounting (Note 24).

The financial statements prior to March 2, 2012 have been prepared on a Partnership entity basis. Accordingly, no recognition has been made for income taxes related to Partnership income in the financial statements prior to March 2, 2012. The tax attributes of the Partnership's net assets flowed directly to the partners.

2. Basis of Preparation

Statement of compliance

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRSs" or "IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were authorized for issue by the Board of Directors on February 13, 2013.

Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis, except for the following material items:

- Derivative financial instruments are measured at fair value;
- Financial instruments classified as fair value through profit and loss are measured at fair value;
- Asset retirement obligations are measured at the discounted value of expected future cash flows; and
- The retirement benefit obligation recognized in the balance sheet in respect of a defined benefit pension plan is the net of the accrued benefit obligation and the fair value of the plan assets.

Use of estimates and judgments

The preparation of the consolidated financial statements in accordance with IFRSs requires management to make judgments, estimates and assumptions that effect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The Company regularly reviews its estimates and assumptions; however, it is possible that circumstances may arise which cause actual results to differ from management estimates, and these differences could be material. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about the significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant affect on the amounts recognized in the consolidated financial statements is included in the applicable notes:

- Note 11 – Employee Future Benefits; and
- Note 12 – Asset Retirement Obligations.

3. Significant Accounting Policies

The following accounting policies have been applied to the financial information presented.

Basis of consolidation

Subsidiaries are entities controlled by the Company. Control exists when CPPI is able to govern the financial and operating activities of those other entities to generate returns for the Company. Inter-company transactions, balances and unrealized gains and losses on transactions between different entities within the Company are eliminated.

Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and highly liquid money market instruments with maturities of three months or less from the date of acquisition, and are valued at cost, which approximates market value. Cash is presented net of unpresented cheques. When the amount of unpresented cheques is greater than the amount of cash, the net amount is presented as cheques issued in excess of cash on hand. Interest is earned at variable rates dependent on amount, credit quality and term.

Financial instruments

Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through net income, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below:

Financial assets at fair value through net income - An instrument is classified at fair value through net income if it is held for trading or is designated as such upon initial recognition. Financial instruments at fair value through net income are measured at fair value, and changes therein are recognized in the statement of income, with attributable transaction costs being recognized in net income when incurred.

Available-for-sale financial assets - Available for sale financial assets are non-derivatives that are either designated in this category or not classified in any other categories. Currently, CPPI does not have any assets included in this category.

Loans and receivables - Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are measured at amortized cost using the effective interest method, less any impairment losses. The effective interest method is used to spread the total costs of or income from a financial instrument over the life of the instrument. Financial assets included within this category for CPPI are trade and other receivables, and cash and cash equivalents. Cash and cash equivalents include cash in bank accounts and highly liquid money market instruments with maturities of three months or less from the date of acquisition.

Other liabilities - All of CPPI's financial liabilities are measured at amortized cost using the effective interest method.

Derivative financial instruments

CPPI uses derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange, interest rate and energy price risk. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

CPPI's derivative financial instruments are not designated as hedges for accounting purposes. Consequently, such derivatives for which hedge accounting is not applied are carried on the balance sheet at fair value, with changes in fair value (realized and unrealized) being recognized in the statements of income as 'Gain (loss) on derivative financial instruments'.

The fair value of the derivatives is determined with reference to period end market trading prices for derivatives with comparable characteristics.

Inventories

Inventories include pulp, paper, wood chips, and materials and supplies. These are measured at the lower of cost and net realizable value. The cost of inventories is based on the weighted average cost principle, and includes raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realizable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses.

Property, plant and equipment

Items of property, plant and equipment, including expenditure on major inspections and overhauls, are measured at cost less accumulated amortization and impairment losses.

Cost includes expenditures which are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, borrowing costs (as applicable), and any other costs directly attributable to bringing assets to be used in the manner intended by management.

Expenditure on major overhauls, refits or repairs is capitalized where it enhances the life or performance of an asset above its originally assessed standard of performance. Certain expenditures relating to replacement of components incurred during major maintenance are capitalized and amortized over the estimated benefit period of such expenditures. The costs of the day-to-day servicing of property, plant and equipment are recognized in net income as incurred.

The cost of replacing a major component of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to CPPI and its cost can be measured reliably. The carrying amount of the replaced component is removed.

Amortization is recognized in net income on a straight-line basis over the estimated useful lives of each component of an item of property, plant and equipment, as set out in the table below. Land is not amortized. The significant majority of CPPI's amortization expense for property, plant and equipment relates to manufacturing and product costs.

Amortization methods, useful lives and residual values are reviewed, and adjusted if appropriate, at each reporting date. The following rates have been applied to CPPI's capital assets:

Buildings	10 to 50 years
Pulp and paper machinery and equipment	20 years
Mobile equipment	4 years
Office furniture and equipment	10 years
Major overhauls	1 to 2 years

Government assistance

Government assistance relating to the acquisition of property, plant and equipment is recorded as a reduction of the cost of the asset to which it relates, with any amortization calculated on the net amount. Government grants related to income are recognized as income or a reimbursement of costs on a systematic basis over the periods necessary to match them with the related costs which they were intended to compensate.

Asset impairment

CPPI's property, plant and equipment are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized in net income at the amount the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of cash inflows from other assets or groups of assets (cash-generating units or "CGU").

Non-financial assets, for which an impairment was recorded in a prior period are reviewed for possible reversal of the impairment at each reporting date. When an impairment loss is reversed, the increased carrying amount of the asset cannot exceed the carrying amount that would have been determined (net of amortization) had no impairment loss been recognized in prior years.

Financial assets are reviewed at each reporting date to determine whether there is evidence indicating they are impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative impact on estimated future cash flows from that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. All impairment losses are recognized in net income.

Employee benefits

Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity makes contributions to a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in net income when they are earned.

For hourly employees covered by industry union defined contribution pension plans, the statement of income are charged with CPPI's contributions required under the collective agreements.

Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. CPPI, in participation with Canfor, has defined benefit plans that provide both pension and other retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. The Company also provides certain health care benefits and pension bridging benefits to eligible retired employees.

The liability recognized in the balance sheet in respect of a defined benefit pension plan is the net of the accrued benefit obligation and the fair value of the plan assets. The accrued benefit obligation is calculated separately for each plan by estimating the amount of future benefit earned by employees in respect of their service in the current and prior periods; that benefit is discounted to determine its present value. The discount rate used to determine the present value of the obligation is the yield at the reporting date on high quality corporate bonds that have maturity dates approximating the terms of CPPI's obligations. The calculation is performed annually by a qualified actuary using the projected unit credit method and a measurement date of December 31. The pension deficit or surplus is adjusted on a quarterly basis for any material changes in underlying assumptions.

CPPI recognizes all actuarial gains and losses arising from defined benefit plans in other comprehensive income in the year in which they occur.

Provisions

CPPI recognizes a provision if, as a result of a past event, it has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. The provision recorded is management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The expense arising from the unwinding of the discount due to the passage of time is recorded as a finance cost. The main class of provision recognized by CPPI is as follows:

Asset retirement obligations

CPPI recognizes a liability for asset retirement obligations in the period in which they are incurred. The site restoration costs are capitalized as part of the cost of the related item of property, plant and equipment and amortized on a basis consistent with the expected useful life of the related asset. Asset retirement obligations are discounted at the risk-free rate in effect at the balance sheet date.

Revenue recognition

CPPI's revenues are derived from the sale of the following major product lines: pulp, paper, energy and sales commissions. Revenue is measured at the fair value of the consideration received or receivable net of applicable sales taxes, returns, rebates and discounts and after eliminating sales within the Company. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible returns of the goods can be estimated reliably, there is no continuing management involvement with the goods, and the amounts of revenue can be measured reliably. Energy revenue is recognized when CPPI has met the terms and conditions under both the Electricity Purchase and Load Displacement Agreements with BC Hydro.

Amounts charged to customers for shipping and handling are recognized as revenue, and shipping and handling costs incurred by CPPI are reported as a component of operating income.

Income taxes

Income tax expense comprises current and deferred tax. Current and deferred tax are recognized in net income except to the extent that they relate to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using the tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous periods.

CPPI recognizes deferred income tax in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is measured at tax rates expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred income tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred income tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Investment tax credits are credited to manufacturing and product costs in the period in which it becomes reasonably assured that the Company is entitled to them. Unused investment tax credits are recorded as other current or long-term assets in the Company's balance sheet, depending upon when the benefit is expected to be received.

The financial statements prior to March 2, 2012 have been prepared on a Partnership entity basis. Accordingly, no recognition has been made for income taxes related to Partnership income in the financial statements prior to March 2, 2012.

Foreign currency translation

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The majority of CPPI sales and long-term debt is denominated in foreign currencies, principally the US dollar. Transactions in foreign currencies are translated to the functional currencies of the respective entities at exchange rates at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate on that date. Foreign currency differences arising on translation are recognized in net income.

The assets and liabilities of foreign operations are translated to the Canadian dollar at exchange rates at the reporting date. The income and expenses of foreign operations are translated to the Canadian dollar at exchange rates at the transaction dates. Foreign exchange differences are recognized in other comprehensive income.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. Segment results reported to the chief operating decision-maker include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise interest bearing liabilities, head office expenses, and income tax assets and liabilities. Segment capital expenditure is the total cost incurred during the period to acquire property, plant and equipment.

4. Changes in Accounting Policy

Effective January 1, 2012, the Company retroactively changed its accounting policy for the presentation of interest expense and expected rate of return on assets of defined benefit post-retirement plans. The net expense has been reclassified from operating income, where it was included in manufacturing and product costs, to net finance expense. Management considers the classification of net pension interest expense with the Company's other interest expense to provide more relevant information on the operating results of the Company. The effect on the financial statements for the year ended December 31, 2012 is an increase in operating income and net finance expense of $3.2 million (2011 - $2.9 million). There is no impact on amounts recorded in the consolidated balance sheet or opening equity as at January 1, 2012.

Accounting standards issued and not applied

Unless otherwise noted, the following new or revised standards and amendments as adopted by the IASB are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. These new and revised accounting standards have not yet been adopted by CPPI and the Company does not plan to early adopt any of these standards.

Consolidation and interests in other entities

In May 2011, as part of its consolidation project, the IASB issued the following new suite of consolidation and related standards. The suite is intended to cover all aspects of interests in other entities from determination of how to account for interests in other entities to required disclosure of the interest in those entities. Early adoption is permitted provided that the entire suite of consolidation standards is adopted at the same time.

- IFRS 10, *Consolidated Financial Statements,* requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvements with the investee and has the ability to affect those returns through its power over the investee. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities,* and parts of IAS 27, *Consolidated and Separate Financial Statements.* IFRS 10 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

- IFRS 11, *Joint Arrangements,* redefines joint operations and joint ventures with a focus on the rights and obligations of an arrangement, rather than its legal form. The new Standard requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures,* and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers.* IFRS 11 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

- IFRS 12, *Disclosure of Interests in Other Entities,* carries forward existing disclosure requirements and introduces additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities. IFRS 12 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

- There have been amendments to existing standards, including IAS 27 (2011), *Separate Financial Statements,* and IAS 28 (2011), *Investments in Associates and Joint Ventures.* IAS 27 (2011) addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 (2011) sets out the equity accounting for joint ventures and associates, once the assessment of the arrangement has been made under IFRS 11. The amendments to IAS 27 and IAS 28 are not expected to have a material impact on amounts recorded in the financial statements of the Company.

Employee benefits

- IAS 19, *Employee Benefits,* has been amended to make changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits. Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past-service costs (including plan amendments, settlements and curtailments)); and (ii) finance expense or income. Interest cost and expected return on plan assets, which currently reflect different rates, will be replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset). The principal impact on the Company of this portion of the amended standard is expected to be an increase in net finance cost as the Company's return on plan assets will effectively be estimated at a lower rate.

  The amended Standard also requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. This is consistent with the Company's current accounting policy.

  In addition, under the amended standard, the impact of plan amendments related to past service will no longer be recognized over a vesting period but instead will be recognized immediately in the period of a plan amendment.

  The amended standard will result in an increase in operating income of approximately $1.1 million offset by an increase in finance expense of approximately $1.4 million in the 2012 comparative financial statements.

Other standards and amendments

- IFRS 9, *Financial Instruments,* addresses classification and measurement of financial assets and financial liabilities, and is effective January 1, 2015, with earlier adoption permitted. The new Standard limits the number of categories for classification of financial assets to two: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Equity instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

- IFRS 13, *Fair Value Measurement,* clarifies that fair value is the price that would be received on sale of an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. IFRS 13 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

- IAS 1, *Presentation of Financial Statements,* has been amended to require entities to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not items may be recycled to net income in the future. The amendment is effective for annual periods beginning on or after July 1, 2012, with earlier application permitted. IAS 1 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

5. Inventories

(millions of Canadian dollars)	**As at December 31, 2012**	As at December 31, 2011
Pulp	**$ 59.4**	$ 64.1
Paper	**18.2**	17.0
Wood chips	**10.9**	16.0
Materials and supplies	**45.6**	44.5
	$ 134.1	$ 141.6

In 2012, costs of raw materials, consumables and changes in finished products recognized as manufacturing and product costs amounted to $305.5 million (2011 - $312.2 million).

6. Property, Plant and Equipment

(millions of Canadian dollars)	Land and improvements	Buildings, machinery and equipment	Asset retirement - landfill	Construction in Progress	Major Overhauls	Total
Cost						
Balance at January 1, 2011	$ 5.4	$ 1,356.1	$ 2.3	$ 3.7	$ 37.0	$ 1,404.5
Additions[1]	-	-	(0.2)	86.4	-	86.2
Disposals	-	(16.4)	-	-	(27.2)	(43.6)
Transfers	-	44.9	-	(75.3)	30.4	-
Balance at December 31, 2011	$ 5.4	$ 1,384.6	$ 2.1	$ 14.8	$ 40.2	$ 1,447.1
Additions[1]	-	-	-	66.2	-	66.2
Disposals	-	(14.0)	-	-	(11.8)	(25.8)
Transfers	-	50.9	-	(65.0)	14.1	-
Balance at December 31, 2012	$ 5.4	$ 1,421.5	$ 2.1	$ 16.0	$ 42.5	$ 1,487.5
Amortization						
Balance at January 1, 2011	$ -	$ (867.0)	$ (0.9)	$ -	$ (23.1)	$ (891.0)
Amortization for the year	-	(50.2)	-	-	(16.5)	(66.7)
Disposals	-	15.4	-	-	27.2	42.6
Balance at December 31, 2011	$ -	$ (901.8)	$ (0.9)	$ -	$ (12.4)	$ (915.1)
Amortization for the year	-	(44.4)	-	-	(22.7)	(67.1)
Disposals	-	13.7	-	-	11.8	25.5
Balance at December 31, 2012	$ -	$ (932.5)	$ (0.9)	$ -	$ (23.3)	$ (956.7)
Carrying amounts						
At January 1, 2011	$ 5.4	$ 489.1	$ 1.4	$ 3.7	$ 13.9	$ 513.5
At December 31, 2011	$ 5.4	$ 482.8	$ 1.2	$ 14.8	$ 27.8	$ 532.0
At December 31, 2012	**$ 5.4**	**$ 489.0**	**$ 1.2**	**$ 16.0**	**$ 19.2**	**$ 530.8**

[1] Net of capital expenditures financed by the federal government-funded Green Transformation Program and other government grants.

7. Green Transformation Program

In October 2009, the Canadian federal government announced the introduction of a Pulp and Paper Green Transformation Program (the "Program") designed to reimburse funds spent by Canadian pulp producers on qualifying energy and environmental capital projects. CPPI was allocated $122.2 million with an additional $44.8 million of Partnership funded expenditure for a total of $167.0 million on qualifying expenditures under this program. By the end of 2011, CPPI had spent its full allocation under the Program most of which related to the installation of a recovery boiler and a precipitator upgrade at its Northwood pulp mill. CPPI received the remaining reimbursements totalling $19.7 million in 2012 (2011 - $75.6 million).

8. Accounts Payable and Accrued Liabilities

(millions of Canadian dollars)	**As at December 31, 2012**	As at December 31, 2011
Trade payables and accrued liabilities	**$ 42.5**	$ 62.9
Accrued payroll and related liabilities	**32.7**	33.5
Other	**18.2**	21.5
	$ 93.4	$ 117.9

9. Operating Loans

(millions of Canadian dollars)		As at December 31, 2012		As at December 31, 2011
Operating loan facility	**$**	**110.0**	$	40.0
Bridge loan credit facility (maximum $30.0 million)		**-**		19.7
Facility for BC Hydro letter of credit		**7.5**		10.4
Total operating loans		**117.5**		70.1
Drawn		**-**		-
Letters of credit (for general business purposes)		**(1.7)**		(0.5)
BC Hydro letter of credit		**(7.5)**		(10.4)
Total available operating loans	**$**	**108.3**	$	59.2

The terms of the Company's operating loan facility include interest payable at floating rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, amortization and certain other non-cash items, and is based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. In the fourth quarter of 2012, CPLP entered into a new $110.0 million operating loan facility replacing its previous $40.0 million operating loan facility. The new facility has certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity. The maturity date of the new facility is November 13, 2016.

During 2012, the Company terminated its $30.0 million bridge loan credit facility in conjunction with the completion of the Canadian Federal Government Green Transformation Program. The facility was used to fund timing differences between expenditures and reimbursements for projects funded by the Program. The Company has a separate facility with a maturity date of November 30, 2013 to cover a $7.5 million standby letter of credit issued to BC Hydro.

As at December 31, 2012, the Company was in compliance with all covenants relating to their operating loans.

10. Long-Term Debt

CPPI has the following long-term debt, all of which is unsecured:

Summary of long-term debt

(millions of Canadian dollars)		As at December 31, 2012		As at December 31, 2011
Canfor Pulp Limited Partnership				
US$110 million, interest at 6.41%, repayable November 30, 2013	**$**	**109.4**	$	111.9
Less: current portion		**109.4**		-
Long-term portion	**$**	**-**	$	111.9

The note agreement contains covenants in relation to earnings before interest, taxes, depreciation, and amortization ("EBITDA"), including a maximum allowable debt:EBITDA leverage ratio and a minimum required EBITDA:interest coverage ratio.

As at December 31, 2012, the Company was in compliance with all covenants relating to the long-term debt.

Fair value of long-term total debt

The fair value of total long-term debt at December 31, 2012 was $113.6 million (2011 – $117.4 million). The fair value was determined using prevailing market rates for long-term debt with similar characteristics and risk profiles.

Scheduled long-term debt repayments and interest payments

The Company will make a scheduled debt repayment of $109.4 million and interest repayment of $7.0 million in 2013.

11. Employee Future Benefits

The Company, in participation with Canfor, has several funded and unfunded defined benefit plans, as well as defined contribution plans, that provide pension, other retirement and post-employment benefits to substantially all salaried employees and certain hourly employees. The defined benefit plans are based on years of service and final average salary. CPPI's other post-retirement benefit plans are non-contributory and include a range of health care and other benefits.

Total cash payments for employee future benefits for 2012 were $18.1 million (2011 – $17.9 million), consisting of cash contributed by CPPI to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to its defined contribution plans.

Defined benefit plans

CPPI measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year.

In 2012, CPPI had two registered defined benefit plans for which actuarial valuations are performed every three years. The most recent actuarial valuation for funding purposes of CPPI's single largest pension plan was as of December 31, 2010, and the next required plan valuation is currently scheduled for December 31, 2013.

Information about CPPI's defined benefit plans, in aggregate, is as follows:

Defined Benefit Plan Assets

	2012		2011	
(millions of Canadian dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets				
Beginning of year	**$ 72.3**	**$ -**	$ 64.7	$ -
Actual return on plan assets	**8.7**	**-**	1.4	-
CPPI contributions	**7.8**	**1.6**	7.9	1.4
Employee contributions	**0.2**	**-**	0.2	-
Benefit payments	**(1.7)**	**(1.6)**	(1.9)	(1.4)
End of year	**$ 87.3**	**$ -**	$ 72.3	$ -

Plan assets consist of the following:	**As at December 31, 2012**	As at December 31, 2011
	Percentage of Plan Assets	
Asset category		
Equity securities	**66%**	61%
Debt securities	**33%**	39%
Other	**1%**	-%
	100%	100%

Defined Benefit Plan Obligations

(millions of Canadian dollars)	2012 Pension Benefit Plans	2012 Other Benefit Plans	2011 Pension Benefit Plans	2011 Other Benefit Plans
Accrued benefit obligation				
Beginning of year	**$ 86.5**	**$ 70.9**	$ 75.5	$ 58.5
Current service cost	**3.1**	**1.5**	2.9	1.1
Interest cost	**4.4**	**3.7**	4.2	3.3
Employee contributions	**0.2**	**-**	0.2	-
Benefit payments	**(1.7)**	**(1.6)**	(1.9)	(1.4)
Plan amendment gain	**-**	**(5.3)**	-	-
Actuarial loss	**8.3**	**11.2**	5.6	9.5
Other	**-**	**(0.5)**	-	(0.1)
End of year	**$ 100.8**	**$ 79.9**	$ 86.5	$ 70.9

The total obligation for the defined benefit plan of $100.8 million (2011 - $86.5 million) is wholly or partly funded. At December 31, 2012 the total obligation for the other benefit plans of $79.9 million (2011 - $70.9 million) is unfunded.

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

(millions of Canadian dollars)	December 31, 2012 Pension Benefit Plans	December 31, 2012 Other Benefit Plans	December 31, 2011 Pension Benefit Plans	December 31, 2011 Other Benefit Plans
Fair market value of plans assets	**$ 87.3**	**$ -**	$ 72.3	$ -
Accrued benefit obligation	**(100.8)**	**(79.9)**	(86.5)	(70.9)
Funded status of plans – surplus (deficit)	**$ (13.5)**	**$ (79.9)**	$ (14.2)	$ (70.9)
Unamortized past service costs	**-**	**(1.3)**	-	-
Accrued benefit liability	**$ (13.5)**	**$ (81.2)**	$ (14.2)	$ (70.9)
Pension bridge benefits	**(9.5)**	**-**	(9.0)	-
Other pension plans	**(0.9)**	**-**	(0.7)	-
Total accrued benefit liability, net	**$ (23.9)**	**$ (81.2)**	$ (23.9)	$ (70.9)

The following table shows the experience adjustments arising on plan liabilities and assets as a result of the differences between actuarial assumptions made at the beginning of the year and the actual experience during the year:

(millions of Canadian dollars)	2012 Pension Benefit Plans	2012 Other Benefit Plans	2011 Pension Benefit Plans	2011 Other Benefit Plans
Experience gain (loss) arising on plan liabilities	**$ 0.3**	**$ -**	$ 1.2	$ 0.1
Experience gain (loss) arising on plan assets	**$ 3.5**	**$ -**	$ (3.7)	$ -

Components of pension cost

The following table shows the before tax impact on net income and other comprehensive income of the Company's pension and other defined benefit plans:

	2012		2011	
(millions of Canadian dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Recognized in net income				
Current service cost	**$ 3.1**	**$ 1.5**	$ 2.9	$ 1.1
Interest cost	**4.4**	**3.7**	4.2	3.3
Expected return on plan assets	**(5.3)**	**-**	(5.0)	-
Plan amendment gain	**-**	**(4.0)**	-	-
Other	**-**	**(0.5)**	-	(0.1)
Total, included in staff costs	**$ 2.2**	**$ 0.7**	$ 2.1	$ 4.3
Recognized in other comprehensive income				
Actuarial loss (gain) immediately recognized	**$ 4.9**	**$ 11.2**	$ 9.3	$ 9.5
Total pension cost recognized in other comprehensive income	**$ 4.9**	**$ 11.2**	$ 9.3	$ 9.5

The expected return on plan assets is determined by taking into account the expected returns on the assets based on the Company's current investment policy.

Significant assumptions

The actuarial assumptions used in measuring CPPI's benefit plan provisions and benefit costs are as follows:

	December 31, 2012		December 31, 2011	
	Pension Benefit Plans	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Accrued benefit obligations at reporting date:				
Discount rate	**4.20%**	**4.40%**	5.00%	5.30%
Rate of compensation increases	**3.00%**	**n/a**	3.00%	n/a
Benefit costs for year ended December 31:				
Discount rate	**5.00%**	**5.30%**	5.50%	5.75%
Expected return on plan assets	**7.00%**	**n/a**	7.00%	n/a
Future salary increases	**3.00%**	**n/a**	3.00%	n/a

Assumed health care cost trend rates

(weighted average assumptions)	**December 31, 2012**	December 31, 2011
Initial health care cost trend rate	**6.28%**	6.33%
Ultimate health care cost trend rate	**4.50%**	4.50%
Year ultimate rate is reached	**2029**	2029

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 2012:

(millions of Canadian dollars)	1% Increase	1% Decrease
Effect on accrued benefit obligation	$ 15.2	$ 11.9
Effect on the aggregate service and interest cost	$ 1.3	$ 1.0

For the Company's single largest pension plan, a one percentage point increase in the rate of return on plan assets over the year would reduce the funded deficit by an estimated $0.8 million. A one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would reduce the funded deficit by an estimated $12.8 million. These changes would only impact the Company's funding requirements in years where a new actuarial funding valuation was performed and approval for a change in annual funding contributions was obtained from the regulator.

As at December 31, 2012, CPPI estimates that it will make contribution payments of $9.5 million to its defined benefit plans in 2013.

Historical information

The historical information below includes both funded and unfunded pension benefit plans in aggregate.

(millions of Canadian dollars)	**2012**	2011	2010
Fair value of the plan assets	**$ 87.3**	$ 72.3	$ 64.7
Present value of the defined benefit obligation	**(180.7)**	(157.4)	(134.0)
Pension bridge benefits	**(9.5)**	(9.0)	(9.9)
Other pension plans	**(0.9)**	(0.7)	(0.6)
Unamortized past service costs	**(1.3)**	-	-
Funded status of the plans - deficit	**(105.1)**	(94.8)	(79.8)
Experience gain arising on plan liabilities	**$ 0.3**	$ 1.3	$ 0.1
Experience gain (loss) arising on plan assets	**$ 3.5**	$ (3.7)	$ 1.3

Defined contribution and other plans

The total cost recognized in 2012 for CPPI's defined contribution plans was $1.2 million (2011 - $1.0 million).

CPPI contributes to a pulp industry pension plan providing pension benefits. This plan is accounted for as defined contribution plan. Contributions to this plan, not included in the cost recognized for defined contribution plan above, amounted to $6.7 million in 2012 (2011 - $6.7 million).

Employee future benefit plan amendments

During the fourth quarter of 2012, the Company amended the salaried post retirement benefit plans for certain CPPI employees and retirees. The amendments reduce the Company's retirement benefit obligation by $5.3 million (before tax). As a result of the plan amendments, CPPI recognized a gain of $4.0 million (before tax) for vested past-service costs and deferred a gain of $1.3 million (before tax) for unvested past-service costs. The deferred gain will be recognized on a straight line basis over the vesting period.

Other

CPPI's total employee benefits expense includes salaries and wages, future employee benefits and terminations as applicable. The total employee benefit expenses for the year ended December 31, 2012 was $0.2 million (2011- $0.2 million).

12. Asset Retirement Obligations

The following table provides a reconciliation of the asset retirement obligations as at December 31, 2012 and 2011:

(millions of Canadian dollars)		2012		2011
Asset retirement obligations at beginning of year	**$**	**3.1**	$	3.1
Accretion expense		**0.2**		-
Asset retirement obligations at end of year	**$**	**3.3**	$	3.1

CPPI's asset retirement obligations represent estimated undiscounted future payments of $7.2 million to remediate the landfills at the end of their useful lives. The payments are expected to occur at periods ranging from 6 to 39 years and have been discounted at risk-free rates ranging from 1.6% to 2.4%.

CPPI has certain assets that have indeterminable retirement dates and, therefore, there is an indeterminate settlement date for the related asset retirement obligations. As a result, no asset retirement obligations are recorded for these assets. These assets include 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, fuels and other related materials will be required once the related operating facility is closed. When the retirement dates of these assets become determinable and an estimate can be made, an asset retirement obligation will be recorded.

It is possible that changes in future conditions could require a material change in the recognized amount of the asset retirement obligations.

The asset retirement obligations balance is included in other long-term provisions on the balance sheet.

13. Share Capital

Authorized

Unlimited number of common shares

Issued and Fully Paid

(millions of Canadian dollars, except number of shares)	2012			2011		
	Number of Shares		**Amount**	Number of Shares		Amount
Common shares, beginning of year	**35,776,483**	**$**	**294.9**	35,776,483	$	294.9
Exchange transaction (Note 24)	**35,493,307**		**230.4**	-		-
Common Shares at end of year	**71,269,790**	**$**	**525.3**	35,776,483	$	294.9

The holders of common shares are entitled to vote at all meetings of shareholders of the Company and are entitled to receive dividends when declared.

14. Finance Expense, Net

(millions of Canadian dollars)		2012		2011
Finance expense	**$**	**(12.0)**	$	(11.3)
Less: Interest income		**0.2**		0.4
Finance expense, net	**$**	**(11.8)**	$	(10.9)

Finance expense, net is comprised of:

(millions of Canadian dollars)		2012		2011
Short-term finance expense, net	**$**	**(1.3)**	$	(0.8)
Long-term finance expense, net		**(10.5)**		(10.1)
Finance expense, net	**$**	**(11.8)**	$	(10.9)

For the year ended December 31, 2012, short-term finance expense, net is comprised of stand-by fees for operating loans and letter of credit charges of $1.5 million (2011 - $1.2 million), offset by interest income on cash and cash equivalents of $0.2 million (2011 - $0.4 million). Long-term finance expense, net relates substantially to interest expense on long-term debt of $7.1 million (2011 - $7.0 million), employee future benefit expense of $3.2 million (2011 - $2.9 million), and accretion expense related to the Company's asset retirement obligations of $0.2 million (2011 - $0.2 million).

15. Income Taxes

Income tax expense includes current tax expense on income for the March 2, 2012 to December 31, 2012 period. Prior to the Exchange on March 2, 2012, taxes were minimal reflecting the non-taxable status of the Partnership (Note 24).

(millions of Canadian dollars)		2012
Current	$	**(1.4)**
Deferred		**(0.6)**
Income tax recovery (expense)	$	**(2.0)**

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows:

(millions of Canadian dollars)		2012
Income tax expense at statutory rate 2012 - 25.0%	$	**(3.9)**
Add (deduct):		
Tax expense at rates other than statutory rate		**(0.1)**
Permanent difference from capital gains and other non deductible items		**0.2**
Permanent difference – exchange transaction		**0.9**
Tax included in equity – exchange transaction		**0.9**
Income tax expense	$	**(2.0)**

In addition to the amounts recorded to net income, a tax recovery of $4.1 million was recorded to other comprehensive income for the year ended December 31, 2012 in relation to actuarial losses on defined benefit employee compensation plans.

The tax effects of the significant components of temporary differences that give rise to deferred income tax assets and liabilities are as follows:

(millions of Canadian dollars)		As at December 31, 2012
Deferred income tax assets		
Retirement benefit obligations	$	**26.0**
Other		**1.6**
	$	**27.6**
Deferred income tax liabilities		
Depreciable capital assets	$	**(84.9)**
Unrealized foreign exchange gains on debt (current)		**(2.0)**
Other		**(0.3)**
		(87.2)
Total deferred income taxes, net	$	**(59.6)**

16. Earnings Per Share

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period. The issuance of the new shares as a result of the exchange transaction led to an increase in the weighted average number of shares outstanding, with 71,269,790 outstanding as of December 31, 2012 (Note 24).

	Year ended December 31, 2012	2011
Weighted average number of common shares	**65,257,263**	35,776,483

17. Net Change in Non-Cash Working Capital

(millions of Canadian dollars)		**2012**		2011
Accounts receivable	**$**	**10.9**	$	32.5
Inventories		**7.4**		(18.1)
Prepaid expenses and other assets		**(2.5)**		5.2
Accounts payable and accrued liabilities		**(3.6)**		(32.7)
Net decrease (increase) in non-cash working capital	**$**	**12.2**	$	(13.1)

18. Related Party Transactions

The Company depends on Canfor to provide approximately 59% (2011 - 54%) of its fibre supply as well as to provide certain key business and administrative services as described below. As a result, of these relationships, the Company considers its operations to be dependent on its ongoing relationship with Canfor.

CPPI undertakes transactions with various related entities. These transactions are in the normal course of business and are generally on similar terms as those accorded to unrelated third parties, except where noted otherwise.

The Company purchased wood chips and hog fuel from Canfor sawmills in the amount of $108.1 million in 2012 (2011 - $122.2 million).

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 increased in 2012 to $3.7 million (2011 - $3.3 million) reflecting the integration of various finance and administrative services. These amounts are 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 2012 was $2.3 million (2011 - $2.0 million), included as a cost recovery in manufacturing and product costs and selling and administration costs.

The Company markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill ("Taylor") for which it earned commissions totaling $1.9 million in 2012 (2011 – $1.9 million), included in sales. The Company also purchased chemi-thermo mechanical pulp from Taylor for resale totaling $0.3 million in 2012 (2011 – $0.4 million). The Company sold NBSK pulp to Taylor for packaging use totaling $3.0 million in 2012 (2011 – $3.0 million).

The Company purchased wood chips from Lakeland Mills Ltd., in which Canfor has a 33.3% interest. In 2012, CPPI purchased $2.6 million (2011 - $11.5 million) in wood chips, which are included in manufacturing and product costs.

At December 31, the following amounts were included in the balance sheet of the Company:

(millions of Canadian dollars)		**As at December 31, 2012**		As at December 31, 2011
Balance Sheet				
Included in accounts payable and accrued liabilities:				
Canfor	**$**	**12.9**	$	18.2
Lakeland		**-**		0.9
Included in trade and other accounts receivable:				
Products marketed for Canfor	**$**	**4.4**	$	3.2
Canfor[1]		**3.0**		-

[1] Market rate of interest is charged on all amounts receivable from Canfor.

Key Management Personnel

Key management includes members of the Board of Directors and the Senior Executive management team. The compensation expense for key management for services is as follows:

(millions of Canadian dollars)		**2012**		2011
Short-term benefits	**$**	**5.1**	$	4.5
Post-employment benefits		**0.5**		0.4
Restructuring costs		**1.7**		-
	$	**7.3**	$	4.9

Other Related Parties

Post-employment benefit plans

During the year, CPPI made contributions to certain post-employment benefit plans for the benefit of CPPI employees. Note 11 Employee Future Benefits contains further details.

19. Segment Information

The Company has two reportable segments which operate as separate business units and represent separate product lines.

Sales between pulp and paper segments are accounted for at prices that approximate fair value. These include sales of slush pulp from the pulp segment to the paper segment.

Sales to the largest customer represented approximately 10.6% (2011 – 10.0%) of pulp segment sales.

Information regarding the operations of each reportable segment is included in the table below. The accounting policies of the reportable segments are the same as described in Note 3.

(millions of Canadian dollars)		Pulp	Paper	Unallocated	Elimination Adjustment		Total
Year ended December 31, 2012							
Sales to external customers	**$**	**675.0**	**134.6**	**0.8**	**-**	**$**	**810.4**
Sales to other segments	**$**	**67.2**	**-**	**-**	**(67.2)**	**$**	**-**
Operating income (loss)	**$**	**19.2**	**19.4**	**(14.0)**	**-**	**$**	**24.6**
Amortization	**$**	**63.2**	**3.8**	**0.1**	**-**	**$**	**67.1**
Capital expenditures[1]	**$**	**86.9**	**1.1**	**0.7**	**-**	**$**	**88.7**
Identifiable assets	**$**	**670.9**	**64.6**	**22.5**	**-**	**$**	**758.0**
Year ended December 31, 2011							
Sales to external customers	$	802.9	136.6	1.5	-	$	941.0
Sales to other segments	$	87.9	-	-	(87.9)	$	-
Operating income (loss)	$	157.5	9.5	(13.6)	-	$	153.4
Amortization	$	63.0	3.6	0.2	-	$	66.8
Capital expenditures[1]	$	152.2	2.8	1.1	-	$	156.1
Identifiable assets	$	702.5	63.8	24.9	-	$	791.2

[1] Capital expenditures represent cash paid for capital assets during the period and include capital expenditures financed by the federal government-funded Green Transformation Program and other government grants.

Geographic information

CPPI's products are marketed worldwide, with sales made to companies in a number of different countries. In presenting information on the basis of geographical location, revenue is based on the geographical location of customers.

(millions of Canadian dollars)	**2012**	2011
Sales by location of customer		
Canada	**$ 51.9**	$ 40.0
United States	**253.4**	274.7
Europe	**92.8**	144.0
Asia	**374.9**	442.0
Other	**37.4**	40.3
	$ 810.4	$ 941.0

20. Insurance Claim Receivable

During the second quarter of 2012, an incident at the Northwood Pulp Mill resulted in an unscheduled shutdown and subsequent repairs. The Company recognized a property damage insurance receivable of $5.6 million, which substantially offset the additional maintenance costs related to this incident. This amount was included as a reduction in Manufacturing and Product Costs in the income statement for the year ended December 31, 2012.

The Company recognized a business interruption insurance receivable of $9.7 million, less a deductible of $5.0 million, to recover the estimated impact of year to date lost production. The net insurance proceeds of $4.7 million, was included in Sales for the year ended December 31, 2012.

As at December 31, 2012, the total insurance receivable amount, net of advances received, of $6.3 million is included within Other Accounts Receivable.

21. Commitments

At the end of the year, CPPI had contractual commitments for the construction of capital assets for $9.9 million (2011 - $6.2 million). These commitments are expected to be settled over the following year.

CPPI has committed to operating leases for property, plant and equipment. As at December 31, 2012 and 2011, the future minimum lease payments under these operating leases were as follows:

(millions of Canadian dollars)	**As at December 31, 2012**	As at December 31, 2011
Within one year	**$ 2.0**	$ 1.7
Between one and five years	**2.0**	1.7
Total	**$ 4.0**	$ 3.4

During the year ended December 31, 2012, $3.0 million (2011 - $3.6 million) was recognized as an expense in the income statement in respect of operating leases.

BC Hydro Agreements

The Company's Energy agreement with BC Hydro provides for the sale of power production that exceeds a committed amount from the cogeneration project at the Prince George Pulp and Paper Mill. Under the Cogeneration Agreement with BC Hydro, if the cogeneration project generates less than the 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 Company is required to pay BC Hydro an amount equal to the uncorrected shortfall as a ratio of the annual requirement. Under the agreement, the Company is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated. As of December 31, 2012, the Company has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of $7.5 million (2011 - $10.4 million) has been issued to BC Hydro.

In the fourth quarter of 2012, the Company secured a Load Displacement Agreement ("LDA") and an Energy Purchase Agreement ("EPA") with BC Hydro as part of the Integrated Power Offer program, which provides for the commitment for electrical load displacement and the sale of incremental power production at the Northwood Pulp Mill commencing April 1, 2014. Under the LDA and the EPA agreements the Company is required to post stand by letters of credit as performance security for the term of the agreement. As of December 31, 2012, the Company had no repayment obligations under the terms of both agreements and two standby letters of credit in the amounts of $0.8 million for the EPA and $0.1 million for the LDA, which were issued to BC Hydro as performance security for future power generation commitments.

22. Financial Risk and Capital Management

Financial Risk Management

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

The CPPI Risk Management Committee manages risk in accordance with a Board approved Risk Management Controls Policy. The policy sets out the responsibilities, reporting and counter party credit and communication requirements associated with all of the Company's risk management activity. Responsibility for overall philosophy, direction and approval is that of the Board of Directors.

Credit risk:

Credit risk is the risk of financial loss to CPPI if a customer, bank or third party to a derivative instrument fails to meet its contractual obligations.

Financial instruments that are subject to credit risk include cash and cash equivalents, accounts receivable, and other. Cash and cash equivalents includes cash held through major Canadian and international financial institutions as well as temporary investments with an original maturity date of three months or less.

CPPI utilizes a combination of credit insurance and self-insurance to manage the risk associated with trade receivables. As at December 31, 2012, approximately 83% (2011 - 88%) of the outstanding trade receivables are covered under credit insurance. In addition, CPPI requires letters of credit on certain export trade receivables and periodically discounts these letters of credit without recourse. CPPI recognizes the sale of the letters of credit on the settlement date, and accordingly reduces the related trade accounts receivable balance. At December 31, 2012, CPPI had reduced the trade accounts receivable balance by $40.1 million (2011 – $27.9 million) due to discounting of letters of credit. CPPI's trade receivable balance at December 31, 2012 was $61.6 million (2011 - $70.8 million). At December 31, 2012, approximately 95% of the trade accounts receivable balance was within CPPI's established credit terms (2011 – 98%).

Liquidity risk:

Liquidity risk is the risk that CPPI will be unable to meet its financial obligations on a current basis. CPPI 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.

At December 31, 2012, CPPI had accounts payable and accrued liabilities of $93.4 million (2011 - $117.9 million), cheques issued in excess of cash on hand of $1.2 million (2011 - $2.0 million), and current long-term debt obligations of $109.4 million (2011 - nil), all of which fall due for payment within one year of the balance sheet date. At December 31, 2012, the Company had $117.5 million of unsecured operating loan facilities, which were undrawn, except for $9.2 million reserved for several standby letters of credit.

In the fourth quarter of 2012, the Company obtained a new $110.0 million operating loan facility replacing its previous $40.0 million operating loan facility. The maturity date of the new facility is November 30, 2016.

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.

(i) Interest rate risk:

CPPI is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates and through its operating lease commitments.

Changes in the market interest rates do not have a significant impact on CPPI's results of operations due to the short-term nature of the respective financial assets and obligations. CPPI utilizes interest rate swaps to reduce its exposure to financial obligations bearing variable interest rates. At December 31, 2012 CPPI had $105.0 million in fixed interest rate swaps with interest rates ranging from 2.37% to 2.59% with maturities between 2014 and 2015. The Company had no interest rate swaps at December 31, 2011.

(ii) Currency risk:

CPPI is exposed to foreign exchange risk primarily related to the US dollar, as CPPI 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 Company holds financial assets and liabilities in US dollars. These primarily include US dollar bank accounts and investments, trade accounts receivable and long-term debt.

An increase (decrease) in the value of the Canadian dollar by US$0.01 would result in a pre-tax: (i) loss (gain) of approximately $0.5 million in relation to working capital balances denominated in US dollars at year end (including cash, accounts receivable and accounts payable); (ii) gain (loss) of approximately $1.1 million in relation to long-term debt denominated in US dollars at year end.

A portion of the currency risk associated with US dollar denominated sales is naturally offset by US dollar denominated expenses. The Company enters into US dollar forward sale contracts to reduce exposure to fluctuations in US exchange rates on US dollar denominated accounts receivable and accounts payable balances.

CPPI had the following foreign exchange derivatives at December 31, 2012 and 2011:

	As at December 31, 2012		As at December 31, 2011	
	Notional Amount	**Exchange Rates**	Notional Amount	Exchange Rates
US Dollar Forwards	**(millions of US dollars)**	**(range of rates, per dollar)**	(millions of US dollars)	(range of rates, per dollar)
0-12 months				
US Dollar Forward Contracts	**$ 2.5**	**$ 0.9941**	$ 56.0	$ 1.0112-1.0470

(iii) Commodity price risk:

CPPI's financial performance is dependent on the selling price of its products and the purchase price of raw material inputs. Consequently, CPPI 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, CPPI is subject to reduced revenues and margins, which adversely impact profitability.

The Company may periodically use derivative instruments to mitigate commodity price risk.

(i) Energy price risk:

CPPI is exposed to energy price risk relating to purchases of natural gas and diesel oil for use in its operations.

The exposure is hedged up to 100% through the use of floating to fixed swap contracts or option contracts with maturity dates up to a maximum of three years. In the case of diesel, CPPI uses Western Texas Intermediate oil ("WTI") contracts to hedge its exposure.

As at December 31, 2012, the Company had 48.0 thousand barrels of WTI oil collars, which will be settled in 2013, with weighted average protection of $84.60 per barrel and topside of $97.50 per barrel.

As at December 31, 2011, the Company had 58.0 thousand barrels of WTI oil collars with weighted average protection of $82.97 per barrel and topside of $108.28 per barrel.

Capital management

CPPI's objectives when managing capital are to maintain a strong balance sheet and a globally competitive cost structure, that ensure adequate liquidity to maintain and develop the business through the commodity price cycle, taking into account future capital requirements and debt retirement obligations. In addition, CPPI works with relevant stakeholders to ensure the safety of its operations and employees, and remain in compliance with all environmental regulations

CPPI is comprised of net debt and shareholder's equity:

(millions of Canadian dollars)		**As at December 31, 2012**		As at December 31, 2011
Total Debt	**$**	**109.4**	$	111.9
Cheques issued in excess of cash on hand		**1.2**		2.0
Less: Cash and cash equivalents		**-**		-
Net debt	**$**	**110.6**	$	113.9
Total equity		**385.7**		453.7
	$	**496.3**	$	567.6

CPPI's long-term debt and short-term credit facility agreements contain leverage and interest ratio covenants as described in Note 10 to these financial statements.

23. Financial Instruments

Classification and measurement of financial instruments

CPPI's cash and cash equivalents, accounts receivable, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial recognition.

Derivative instruments are measured at fair value. IFRS 7, *Financial Instruments: Disclosures,* requires classification of these items within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – Inputs that are not based on observable market data.

The following table summarizes CPPI's financial instruments at December 31, 2012 and 2011, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

(millions of Canadian dollars)	Fair Value Hierarchy Level		**As at December 31, 2012**		As at December 31, 2011
Financial assets					
Held for trading					
Derivative financial instruments	Level 2	**$**	**0.1**	$	0.4
Loans and receivables					
Accounts receivable (excluding derivatives)	n/a		**84.3**		110.8
		$	**84.4**	$	111.2
Financial liabilities					
Other liabilities					
Cheques issued in excess of cash on hand	n/a	**$**	**1.2**	$	2.0
Accounts payable and accrued liabilities (excluding derivatives)	n/a		**93.4**		117.9
Long-term debt – including current portion	n/a		**109.4**		111.9
		$	**204.0**	$	231.8

Derivative financial instruments

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, energy costs and interest rates. At December 31, 2012, the fair value of derivative financial instruments was a net asset of $0.1 million (2011 – net asset of $0.4 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on derivative financial instruments for the years ended December 31, 2012 and 2011:

(millions of Canadian dollars)		**2012**		2011
Foreign exchange collars and forward contracts	**$**	**1.7**	$	(1.6)
Crude oil collars		**-**		0.1
Natural gas swaps		**-**		(0.1)
Gain (loss) on derivative financial instruments	**$**	**1.7**	$	(1.6)

The following table summarizes the fair market value of the derivative financial instruments included in the balance sheets at December 31, 2012 and 2011:

(millions of Canadian dollars)		**As at December 31, 2012**		As at December 31, 2011
Foreign exchange collars and forward contracts	**$**	**-**	$	0.3
Crude oil collars		**0.1**		0.1
Total asset (all current)	**$**	**0.1**	$	0.4

24. Acquisition of Interest in Canfor Pulp Limited Partnership

As a result of the Exchange described in Note 1, CPPI's interest in both the Partnership and the General Partner increased from 49.8% to 100% and Canfor acquired a 50.2% interest in CPPI.

The transaction was accounted for as a reverse acquisition under IFRS, with Canfor's interest in the Pulp Business being the acquirer for accounting purposes and CPPI the acquiree for accounting purposes. The Pulp Business is continuing to operate under CPPI, the legal parent. The financial statements have been presented, along with the comparative periods, from the accounting perspective that Canfor's interest in the Pulp Business is the continuing entity after the exchange transaction as it gained control of the Company through a reverse transaction. Prior to March 2, 2012 49.8% of the Pulp Business was held by CPPI and reflected as non-controlling interest. Net income and comprehensive income attributable to CPPI's non-controlling interest in the Pulp business was $4.3 million for the year ended December 31, 2012. Canfor's interest in the Pulp Business was deemed to acquire CPPI on March 2, 2012, as a result of the transaction non-controlling interest of $230.4 million was eliminated and 35,493,307 shares in the amount of $230.4 million were deemed issued and included in share capital.

The consolidated financial statements include the balance sheets, statements of income, statements of other comprehensive income, statements of changes in equity, and cash flows of CPPI, the Partnership and the subsidiaries of those entities from March 2, 2012.

Management estimates that the fair value of CPPI's assets and liabilities approximate their carrying values at March 2, 2012 (note – CPPI's investment in the Partnership eliminates upon consolidation). Excluding the investment in the Partnership, the carrying values of the assets and liabilities of CPPI at March 2, 2012 were as follows:

(millions of Canadian dollars)		As at March 2, 2012
Assets acquired:		
Cash and cash equivalents	$	6.8
Liabilities assumed:		
Due to Canfor Pulp Limited Partnership	$	0.1
Income taxes payable	$	0.2
Deferred income tax liability	$	31.4

As a result of the exchange there was no change in control for the Pulp Business. The difference between the carrying value of the non-controlling interest and the assets and liabilities acquired was recognized directly in equity as a charge to retained earnings (deficit).

(millions of Canadian dollars)		Total
Cash	$	6.8
Deferred taxes		(63.2)
Income taxes payable		(1.3)
Other liabilities		(0.1)
Charge to retained earnings (deficit) as at March 2, 2012	$	(57.8)

25. Subsequent Event

On February 13, 2013, the Board of Directors reinstated the Company's dividend, declaring a quarterly dividend of $0.05 per share, payable on March 5, 2013 to shareholders of record on February 26, 2013.