

CANFOR PULP INCOME FUND  
CANFOR PULP LIMITED PARTNERSHIP  
Unaudited Interim Consolidated Financial Statements

For the three and six months ended June 30, 2010

**Canfor Pulp Income Fund**  
**Consolidated Statements of Income (Loss), Comprehensive Income (Loss) and Accumulated**  
**Earnings and Distributions**

(thousands of dollars, except unit and per unit amounts, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Income</b>				
Equity income (loss) in Canfor Pulp Limited Partnership	\$ 21,430	\$ 724	\$ 37,652	\$ (10,016)
Net income (loss) before future income tax recovery	21,430	724	37,652	(10,016)
Future income tax recovery (note 6)	681	3,682	1,003	3,682
Net income (loss)	22,111	4,406	38,655	(6,334)
Distributions declared (note 4)	(18,457)	(1,065)	(29,814)	(3,195)
Earnings in excess of distributions – surplus (deficit)	\$ 3,654	\$ 3,341	\$ 8,841	\$ (9,529)
<b>Net income (loss) per unit, basic and diluted</b>	<b>\$ 0.62</b>	<b>\$ 0.12</b>	<b>\$ 1.09</b>	<b>\$ (0.18)</b>
<b>Weighted average number of units</b>	<b>35,493,505</b>	<b>35,493,505</b>	<b>35,493,505</b>	<b>35,493,505</b>
Net income (loss) for the period	\$ 22,111	\$ 4,406	\$ 38,655	\$ (6,334)
Equity interest in other comprehensive income (loss) of Canfor Pulp Limited Partnership	51	(9)	24	(30)
<b>Comprehensive income (loss)</b>	<b>\$ 22,162</b>	<b>\$ 4,397</b>	<b>\$ 38,679</b>	<b>\$ (6,364)</b>
<b>Accumulated Earnings and Distributions</b>				
Balance, beginning of period – distributions in excess of earnings	\$ (67,839)	\$ (85,733)	\$ (73,026)	\$ (72,863)
Earnings in excess of distributions – surplus (deficit), current period	3,654	3,341	8,841	(9,529)
<b>Balance, end of period – Accumulated distributions in excess of earnings</b>	<b>\$ (64,185)</b>	<b>\$ (82,392)</b>	<b>\$ (64,185)</b>	<b>\$ (82,392)</b>

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

**Canfor Pulp Income Fund**  
**Consolidated Statements of Cash Flows**

(thousands of dollars, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Cash generated from (used in)</b>				
<b>Operating activities</b>				
Net income (loss)	\$ 22,111	\$ 4,406	\$ 38,655	\$ (6,334)
Items not affecting cash:				
Equity (income) loss in Canfor Pulp Limited Partnership	(21,430)	(724)	(37,652)	10,016
Future income tax recovery	(681)	(3,682)	(1,003)	(3,682)
Distributions received from Canfor Pulp Limited Partnership	15,617	1,065	25,555	4,259
	<b>15,617</b>	<b>1,065</b>	<b>25,555</b>	<b>4,259</b>
<b>Financing activities</b>				
Distributions paid to unitholders	\$ (15,617)	\$ (1,065)	\$ (25,555)	\$ (4,259)
<b>Beginning, change and ending balance in cash and cash equivalents</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

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

**Canfor Pulp Income Fund  
Consolidated Balance Sheets**

(thousands of dollars, unaudited)	As at June 30, 2010	As at December 31, 2009
<b>ASSETS</b>		
<b>Current assets</b>		
Distributions receivable from Canfor Pulp Limited Partnership (notes 4,5)	\$ 7,099	\$ 2,839
Total current assets	7,099	2,839
Equity investment in Canfor Pulp Limited Partnership (note 3)	271,506	263,644
	\$ 278,605	\$ 266,483
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Distributions payable (note 4)	\$ 7,099	\$ 2,839
Total current liabilities	7,099	2,839
Future income taxes (note 6)	36,284	37,287
	\$ 43,383	\$ 40,126
<b>UNITHOLDERS' EQUITY</b>		
Unitholders' equity – 35,493,505 Fund units outstanding	\$ 299,351	\$ 299,351
Accumulated earnings and distributions	(64,185)	(73,026)
Accumulated other comprehensive income (note 7)	56	32
Total Unitholders' Equity	235,222	226,357
	\$ 278,605	\$ 266,483

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

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

Approved by the Trustees

*"Stan Bracken-Horrocks"*

Stan Bracken-Horrocks

*"Charles Jago"*

Charles Jago

## Canfor Pulp Income Fund

### Notes to the Unaudited Interim Consolidated Financial Statements as at June 30, 2010

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

Canfor Pulp Income Fund (the Fund) is an unincorporated open-ended trust established under the laws of Ontario on April 21, 2006, pursuant to the Fund Declaration. The principal head office of the Fund is located at 1700 West 75<sup>th</sup> Avenue, Vancouver, BC, 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.

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.

The Fund expects to convert to a corporation on or about January 1, 2011, pursuant to a plan of arrangement approved at the annual general meeting on April 27, 2010.

#### 2. Significant Accounting Policies

These unaudited interim consolidated financial statements do not include all of the disclosures required by Canadian generally accepted accounting principles for annual financial statements and, accordingly, should be read in conjunction with the audited consolidated financial statements and notes included in the Fund's 2009 Annual Report available at [www.canforpulp.com](http://www.canforpulp.com) or [www.sedar.com](http://www.sedar.com). These unaudited interim consolidated financial statements follow the same accounting policies and methods of computation as used in the 2009 audited consolidated financial statements.

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

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

(thousands of dollars, unaudited)	Six months ended June 30, 2010	Year ended December 31, 2009
Balance, beginning of period	263,644	266,274
Equity interest in income of the Partnership	37,652	6,644
Equity interest in other comprehensive income (loss) of the Partnership	24	(45)
Distributions from the Partnership	(29,814)	(9,229)
Balance, end of period	271,506	263,644

#### 4. Distributions

The Fund declared distributions during the first six months of 2010 as follows:

(thousands of dollars, except per unit amounts, unaudited)			
Record Date	Payable Date	Amount per Fund Unit \$	Amount \$
January 29, 2010	February 15, 2010	0.08	2,839
February 26, 2010	March 15, 2010	0.12	4,259
March 31, 2010	April 15, 2010	0.12	4,259
April 30, 2010	May 14, 2010	0.12	4,259
May 31, 2010	June 15, 2010	0.20	7,099
June 30, 2010	July 15, 2010	0.20	7,099
		0.84	29,814

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

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

## 5. Related Party Transactions

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 three months ended June 30, 2010 were \$18.5 million of which \$11.4 million was received, with the balance of \$7.1 million receivable on June 30, 2010.

## 6. Future Income Taxes

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

(thousands of dollars, unaudited)	Six months ended June 30, 2010	Year ended December 31, 2009
Expected income tax expense at statutory tax rate of nil (2009 – nil)	-	-
Future income tax recovery on temporary differences	<b>(1,003)</b>	(2,422)
	<b>(1,003)</b>	(2,422)

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

(thousands of dollars, unaudited)	June 30, 2010	December 31, 2009
Future income tax liability:		
Equity investment in the Partnership	<b>41,773</b>	42,347
Expected reversal of temporary differences prior to January 1, 2011	<b>(5,489)</b>	(5,060)
	<b>36,284</b>	37,287

The future income tax liability is based on a current estimate of the balance at the beginning of 2011. The balance 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.

## 7. Accumulated Other Comprehensive Income

(thousands of dollars, unaudited)	Six months ended June 30, 2010	Year ended December 31, 2009
Balance, beginning of period	<b>32</b>	77
Other comprehensive income (loss)	<b>24</b>	(45)
Balance, end of period	<b>56</b>	32

## 8. 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.

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.

#### **9. 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 Statements of Income (Loss), Comprehensive Income (Loss) and Partners' Equity**

(millions of dollars, except units and per unit amounts, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Revenue</b>				
Sales	\$ 247.6	\$ 205.0	\$ 487.1	\$ 391.3
Business interruption insurance	-	3.2	-	3.2
	<b>247.6</b>	<b>208.2</b>	<b>487.1</b>	<b>394.5</b>
<b>Costs and expenses</b>				
Manufacturing and product costs	146.8	162.3	304.7	312.1
Freight and other distribution costs	29.8	32.1	60.9	60.9
Amortization	12.0	12.2	23.6	24.2
Selling and administration costs	7.4	6.6	13.8	12.1
	<b>196.0</b>	<b>213.2</b>	<b>403.0</b>	<b>409.3</b>
<b>Operating income (loss)</b>	<b>51.6</b>	<b>(5.0)</b>	<b>84.1</b>	<b>(14.8)</b>
Interest expense, net	(1.9)	(2.5)	(3.9)	(5.1)
Foreign exchange (loss) gain on long-term debt	(5.0)	10.7	(1.6)	6.8
Gain (loss) on derivative financial instruments (note 11)	(3.8)	0.3	(3.4)	(5.4)
Foreign exchange gain (loss) on working capital	2.1	(2.2)	0.3	(1.6)
Other income	0.1	0.2	0.1	-
	<b>(8.5)</b>	<b>6.5</b>	<b>(8.5)</b>	<b>(5.3)</b>
<b>Net income (loss)</b>	<b>43.1</b>	<b>1.5</b>	<b>75.6</b>	<b>(20.1)</b>
Other comprehensive income (loss)				
Adjustment for derivatives (note 14)	0.1	(0.1)	0.1	(0.1)
<b>Comprehensive income (loss)</b>	<b>\$ 43.2</b>	<b>\$ 1.4</b>	<b>\$ 75.7</b>	<b>\$ (20.2)</b>
<b>Net income (loss) per Partnership unit</b> (note 10)				
Basic and diluted	\$ 0.60	\$ 0.02	\$ 1.06	\$ (0.28)
<b>Weighted average Partnership units outstanding</b>	<b>71,270,025</b>	<b>71,270,025</b>	<b>71,270,025</b>	<b>71,270,025</b>
<b>Partners' Equity</b>				
Balance, beginning of period	\$ 538.8	\$ 508.5	\$ 529.1	\$ 534.4
Net income (loss)	43.1	1.5	75.6	(20.1)
Distributions declared to partners (note 13)	(37.1)	(2.1)	(59.9)	(6.4)
Other comprehensive income (loss) (note 14)	0.1	(0.1)	0.1	(0.1)
<b>Balance, end of period</b>	<b>\$ 544.9</b>	<b>\$ 507.8</b>	<b>\$ 544.9</b>	<b>\$ 507.8</b>

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



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

(millions of dollars, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Cash and cash equivalents generated from (used in)</b>				
<b>Operating activities</b>				
Net income (loss)	\$ 43.1	\$ 1.5	\$ 75.6	\$ (20.1)
Items not affecting cash:				
Amortization	12.0	12.2	23.6	24.2
Foreign exchange loss (gain) on long-term debt	5.0	(10.7)	1.6	(6.8)
Reduction (increase) in value of outstanding derivative instruments (note 11)	3.3	(0.1)	4.5	2.8
Employee future benefits	1.9	0.7	3.9	2.2
Change in long-term maintenance provision	2.1	0.6	6.5	1.5
Other	0.1	(0.2)	0.1	(0.2)
Salary pension plan contribution	(0.6)	(0.8)	(1.2)	(1.4)
Long-term maintenance expenditure	(3.4)	(2.6)	(5.8)	(2.6)
Cash flow from operations before working capital changes	63.5	0.6	108.8	(0.4)
Changes in non-cash working capital (note 12)	(22.4)	22.2	(24.2)	45.0
	41.1	22.8	84.6	44.6
<b>Financing activities</b>				
Distributions paid to partners	(31.4)	(2.1)	(51.3)	(8.5)
Operating loan repayment (note 7)	-	(2.5)	-	(10.1)
	(31.4)	(4.6)	(51.3)	(18.6)
<b>Investing activities</b>				
Property, plant and equipment, net (note 12)	(4.1)	(2.2)	(6.5)	(8.2)
Net insurance proceeds	-	0.3	-	0.1
	(4.1)	(1.9)	(6.5)	(8.1)
<b>Increase in cash and cash equivalents</b>	<b>5.6</b>	<b>16.3</b>	<b>26.8</b>	<b>17.9</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>34.7</b>	<b>2.0</b>	<b>13.5</b>	<b>0.4</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 40.3</b>	<b>\$ 18.3</b>	<b>\$ 40.3</b>	<b>\$ 18.3</b>

Supplementary cash flow information (note 12).

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

**Canfor Pulp Limited Partnership  
Consolidated Balance Sheets**

(millions of dollars, unaudited)	As at June 30, 2010	As at December 31, 2009
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 40.3	\$ 13.5
Accounts receivable (note 9)		
Trade	131.8	110.5
Other	17.2	8.6
Inventories (note 3)	138.4	135.4
Prepaid expenses and other assets	21.8	18.4
<b>Total current assets</b>	<b>349.5</b>	286.4
<b>Property, plant and equipment</b> (note 4)	<b>515.1</b>	534.1
<b>Other long-term assets</b> (note 5)	<b>15.7</b>	17.1
	<b>\$ 880.3</b>	<b>\$ 837.6</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 9)	\$ 149.8	\$ 134.5
Distributions payable (note 13)	14.3	5.7
<b>Total current liabilities</b>	<b>164.1</b>	140.2
<b>Long-term debt</b> (note 7)	<b>116.7</b>	115.1
<b>Long-term liabilities</b> (note 8)	<b>54.6</b>	53.2
	<b>\$ 335.4</b>	<b>\$ 308.5</b>
<b>PARTNERS' EQUITY</b> – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (note 1)	<b>544.9</b>	529.1
	<b>\$ 880.3</b>	<b>\$ 837.6</b>

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

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

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

*“Stan Bracken-Horrocks”*

Stan Bracken-Horrocks  
Director

*“Joe Nemeth”*

Joe Nemeth  
Director

## Canfor Pulp Limited Partnership

### Notes to the Unaudited Interim Consolidated Financial Statements as at June 30, 2010

#### 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 June 30, 2010, Canfor owned 50.2% and Canfor Pulp Income Fund (the Fund) indirectly owned 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 unaudited interim consolidated financial statements are those of the Partnership and do not include the assets, liabilities, revenues and expenses of its partners. The Partnership, other than its incorporated subsidiaries, is not subject to income taxes as its income is allocated for tax purposes to its partners. Accordingly, no recognition has been made for income taxes related to Partnership income in these financial statements. The tax attributes of the Partnership's net assets flow directly to the partners.

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

#### *Economic Dependence*

The Partnership depends on Canfor to provide approximately 59% (2009 Year – 63%) of its fibre supply as well as to provide certain key business and administrative services as described in the Fund's 2009 Annual Report available at [www.canforpulp.com](http://www.canforpulp.com) or [www.sedar.com](http://www.sedar.com). As a result of these relationships the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

#### 2. Significant Accounting Policies

These unaudited interim consolidated financial statements do not include all of the note disclosures required by Canadian generally accepted accounting principles for annual financial statements. The Partnership's accounting policies are as disclosed in the annual consolidated financial statements of the Partnership included in the Fund's 2009 Annual Report available at [www.canforpulp.com](http://www.canforpulp.com) or [www.sedar.com](http://www.sedar.com). These unaudited interim consolidated financial statements follow the same accounting policies and methods of computation as used in the 2009 audited consolidated financial statements.

#### 3. Inventories

(millions of dollars, unaudited)	June 30, 2010	December 31, 2009
Pulp	54.6	55.2
Paper	12.8	15.9
Wood chips	28.0	21.5
Processing materials and supplies	43.0	42.8
	<b>138.4</b>	<b>135.4</b>

#### 4. Property, Plant and Equipment

(millions of dollars, unaudited)	June 30, 2010		
	Cost	Accumulated amortization	Net
Land and improvements	5.4	-	5.4
Asset retirement - Landfill	2.3	0.8	1.5
Buildings, machinery and equipment	1,348.7	843.6	505.1
Construction in progress	3.1	-	3.1
	<b>1,359.5</b>	<b>844.4</b>	<b>515.1</b>

(millions of dollars, unaudited)	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
	<b>1,355.0</b>	<b>820.9</b>	<b>534.1</b>

#### 5. Other Long-term Assets

(millions of dollars, unaudited)	June 30, 2010	December 31, 2009
Pension benefit plan	10.6	11.3
Maintenance shutdown costs	4.7	5.4
Other	0.4	0.4
	<b>15.7</b>	<b>17.1</b>

#### 6. Employee Future Benefits

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

Total employee future benefit expenses were as follows:

(millions of dollars, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Pension plans	1.5	1.3	3.0	2.5
Other employee future benefit plans	1.1	0.8	2.2	1.7
Contributions to forest industry union plans	1.7	1.7	3.3	3.3
	<b>4.3</b>	<b>3.8</b>	<b>8.5</b>	<b>7.5</b>

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

At June 30, 2010 the Partnership had outstanding long-term debt of \$116.7 million (December 31, 2009 – \$115.1 million, US\$110.0 million) 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.

The Partnership has a \$40.0 million bank credit facility with a maturity date of November 30, 2011, of which \$0.5 million was utilized at June 30, 2010 for a standby letter of credit issued for general business purposes. In addition, the Partnership has 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. Interest and other costs of the bank credit facility are at prevailing market rates.

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 June 30, 2010 and throughout the period.

The fair value of long-term debt at June 30, 2010 was \$127.2 million (US\$119.9 million).

## 8. Long-term Liabilities

(millions of dollars, unaudited)	June 30, 2010	December 31, 2009
Accrued pension obligations	6.3	5.8
Post-employment benefits	44.6	43.2
Derivative financial instruments (note 11)	0.6	1.2
Asset retirement obligations	3.1	3.0
	<b>54.6</b>	53.2

## 9. Related Party Transactions

The Partnership's transactions with related parties are consistent with the transactions described in the December 31, 2009 audited consolidated financial statements and are based on agreed upon amounts between the parties, and are summarized below:

(millions of dollars, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Transactions</b>				
Canfor	35.5	27.5	69.7	55.0
Howe Sound LP – commission received	0.6	0.6	1.2	1.2
Howe Sound LP – sale of wood chips	-	-	-	0.1
Lakeland Mills Ltd. – purchase of wood chips	1.5	1.3	2.7	1.8
			<b>June 30, 2010</b>	December 31, 2009
<b>Balance Sheet</b>				
Included in accounts payable and accrued liabilities:				
Canfor			42.8	40.8
Howe Sound LP			21.8	17.6
Lakeland Mills Ltd.			0.5	0.4
Included in trade accounts receivable:				
Product marketed for Canfor			21.6	24.4
Product marketed for Howe Sound LP			17.4	16.5

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

## 10. Net Income (Loss) per Partnership Unit

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

## 11. Derivative Financial Instruments

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 second quarter of 2010 the Partnership recorded a net loss on derivative financial instruments of \$3.8 million (second quarter 2009 – gain of \$0.3 million) relating to the settlement of maturing contracts during the quarter, and the revaluation to market of outstanding contracts at the end of the quarter, for natural gas swaps and US dollar forward contracts.

The Partnership recorded losses of \$0.8 million during the second quarter of 2010 (second quarter 2009 – loss of \$2.1 million) relating to settlement of maturing natural gas contracts as a charge to non-operating income. At June 30, 2010 the Partnership had outstanding commodity swaps hedging future natural gas purchases of 1.1 million gigajoules extending to October 2011. At June 30, 2010 the unrealized loss of \$3.7 million (June 30, 2009 – loss of \$6.1 million) on these outstanding commodity swaps was recorded as a liability in accounts payable and accrued liabilities and in long-term liabilities.

The Partnership recorded a gain of \$0.3 million during the second quarter of 2010 (second quarter 2009 – gain of \$2.3 million) on settlement of maturing US dollar forward contracts to non-operating income. At June 30, 2010 the Partnership had outstanding US dollar forward contracts of \$112.3 million extending to October 2010. At June 30, 2010 the unrealized loss of \$3.3 million (June 30, 2009 – loss of \$1.1 million) on these outstanding US dollar forward contracts was recorded as a liability in accounts payable and accrued liabilities.

## 12. Supplementary Cash Flow Information

(millions of dollars, unaudited)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
<b>Decrease (increase) in non-cash working capital</b>				
Accounts receivable – trade and other	(15.6)	(14.6)	(28.8)	(32.3)
Insurance receivable	-	4.3	-	7.3
Inventories	(9.7)	26.9	(3.0)	42.8
Prepaid expenses and other assets	0.6	0.4	(3.4)	3.3
Accounts payable and accrued liabilities	2.3	5.2	11.0	23.9
	<b>(22.4)</b>	22.2	<b>(24.2)</b>	45.0
<b>Capital expenditures</b>				
Capital expenditures – cash	4.1	2.2	6.5	8.2
Less amount reimbursable - Green Transformation Program	(1.6)	-	(1.6)	-
	<b>2.5</b>	2.2	<b>4.9</b>	8.2
Capital expenditures accruals – net accruals	(0.2)	(0.7)	(0.3)	(4.3)
	<b>2.3</b>	1.5	<b>4.6</b>	3.9
<b>Net interest paid</b>	<b>3.7</b>	4.5	<b>3.9</b>	4.8

### 13. Distributions

The Partnership declared distributions in the first six months of 2010 as follows:

(millions of dollars, except per unit amounts, unaudited)

<b>Record Date</b>	<b>Payable Date</b>	<b>Amount per Partnership Unit</b>	<b>Amount</b>
		<b>\$</b>	<b>\$</b>
January 29, 2010	February 15, 2010	0.08	<b>5.7</b>
February 26, 2010	March 15, 2010	0.12	<b>8.5</b>
March 31, 2010	April 15, 2010	0.12	<b>8.6</b>
April 30, 2010	May 14, 2010	0.12	<b>8.6</b>
May 31, 2010	June 15, 2010	0.20	<b>14.2</b>
June 30, 2010	July 15, 2010	0.20	<b>14.3</b>
		0.84	<b>59.9</b>

### 14. Accumulated Other Comprehensive Income

(millions of dollars, unaudited)	<b>Six months ended</b>	Year ended
	<b>June 30, 2010</b>	December 31, 2009
Balance, beginning of period	-	0.1
Adjustment for exchange translation	<b>0.1</b>	(0.2)
Adjustment for derivatives recorded in other comprehensive income	-	0.1
Balance, end of period	<b>0.1</b>	-

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

(millions of dollars, unaudited)	<b>June 30, 2010</b>
Cumulative comprehensive income	<b>352.4</b>
Cumulative distributions	<b>(395.0)</b>
	<b>(42.6)</b>
Partners' capital – at July 1, 2006	<b>587.5</b>
Partners' equity, end of period	<b>544.9</b>

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

(millions of dollars, unaudited)	Pulp	Paper	Unallocated Costs	Total
<b>Three months ended June 30, 2010</b>				
Sales to external customers <sup>(b)</sup>	214.8	32.5	0.3	247.6
Sales of pulp to paper segment <sup>(c)</sup>	24.2	(24.2)	-	-
Operating income (loss)	56.4	(0.5)	(4.3)	51.6
Amortization	11.2	0.8	-	12.0
Capital expenditures, net	1.6	0.4	0.3	2.3
Three months ended June 30, 2009				
Sales to external customers <sup>(b)</sup>	173.8	31.2	-	205.0
Sales of pulp to paper segment <sup>(c)</sup>	12.9	(12.9)	-	-
Operating income (loss)	(6.2)	3.5	(2.3)	(5.0)
Amortization	11.3	0.9	-	12.2
Capital expenditures, net	1.4	-	0.1	1.5
<b>Six months ended June 30, 2010</b>				
Sales to external customers <sup>(b)</sup>	419.6	67.0	0.5	487.1
Sales of pulp to paper segment <sup>(c)</sup>	42.9	(42.9)	-	-
Operating income (loss)	93.5	(1.1)	(8.3)	84.1
Amortization	22.0	1.5	0.1	23.6
Capital expenditures, net	3.3	0.8	0.5	4.6
Identifiable assets	747.8	64.8	67.7	880.3
Six months ended June 30, 2009				
Sales to external customers <sup>(b)</sup>	333.0	58.3	-	391.3
Sales of pulp to paper segment <sup>(c)</sup>	26.6	(26.6)	-	-
Operating income (loss)	(17.8)	7.3	(4.3)	(14.8)
Amortization	22.4	1.7	0.1	24.2
Capital expenditures, net	3.8	-	0.1	3.9
Identifiable assets	740.6	70.5	35.1	846.2

- (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 40% (Year 2009 – 36%).
- (b) Sales to the largest customer represented approximately 12% of pulp segment sales (Year 2009 – 7%).
- (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.