# CANFOR PULP PRODUCTS INC.

## First Quarter Report

For the three months ended March 31, 2013

## To Our Shareholders

Canfor Pulp Products Inc. reported net income of $10.9 million, or $0.15 per share, for the first quarter of 2013, compared to a net income of $5.4[1] million, or $0.08[1] per share, for the fourth quarter of 2012 and net income of $10.0[1] million, or $0.12[1] per share, for the first quarter of 2012.

The Company reported operating income of $19.0 million for the first quarter of 2013, an increase of $6.9 million from operating income of $12.1[1] million reported for the fourth quarter of 2012. The increase primarily reflected modest gains in Northern Bleached Softwood Kraft ("NBSK") pulp sales realizations coupled with a reduction in unit manufacturing costs. Included in results were certain one-time items with the current quarter results including a non-cash $1.5 million benefit from scientific research and development tax credits while the previous quarter included a $5.3[1] million accounting gain related to amendments to the Company's salaried post retirement benefit plans.

The following table summarizes selected financial information for the Company for the comparative periods[1]:

| (millions of Canadian dollars, except per share amounts) | **Q1 2013** | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Sales | **$ 217.5** | $ 201.9 | $ 220.0 |
| Operating income | **$ 19.0** | $ 12.1 | $ 11.5 |
| Net income | **$ 10.9** | $ 5.4 | $ 10.0 |
| Net income per share, basic and diluted | **$ 0.15** | $ 0.08 | $ 0.12 |

Results in the first quarter of 2013 reflected a slight improvement in global softwood pulp markets resulting in prices slowly improving through the quarter. Global softwood pulp shipments and printing and writing demand were relatively flat compared to the previous quarter, with global softwood pulp producer inventory levels in March 2013 at 29 days supply, in line with the end of December 2012.

Compared to the previous quarter, the average NBSK pulp list price to North America increased US$34, or 4%, to US$897 per tonne. Sales to China and Europe were also up through the quarter, with pricing to China up US$16 per tonne and pricing to Europe up US$29 per tonne. Current quarter sales realizations did not match the full list price increases due to increased volumes into lower margin regions, principally China. A slight weakening of the Canadian dollar against the US dollar, down 2%, further contributed to improved Canadian dollar sales realizations.

Contributing to improved pulp segment results were a 5% increase in shipments from the previous quarter, principally reflecting higher volumes to China. Pulp production was up slightly from the previous quarter as a result of improved operating rates during the quarter. Unit manufacturing costs were down 3% from the previous quarter largely the result of lower maintenance costs coupled with the increased production levels, partially offset by seasonally higher energy costs and slightly higher fibre costs.

The Company's paper segment results decreased $1.1 million from the previous quarter, reflecting higher costs for slush pulp and lower sales realizations, mitigated slightly by higher shipment levels.

The Company ended the quarter with cash and cash equivalents of $16.5 million and $108 million available under its operating loans.

[1] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits.* Further details can be found in the Company's unaudited interim consolidated financial statements.

NBSK pulp markets are projected to remain fairly challenging through the second quarter of 2013, but annual spring maintenance downtime should allow for modest price increases. The outlook for the second half of the year is more uncertain given the new hardwood and softwood pulp capacity projected to come online.  For the month of April, the Company announced an increase in the North American NBSK pulp list price of US$30 to US$930 per tonne. Maintenance outages are planned at the Intercontinental and Northwood Pulp Mills during the second quarter of 2013. The Intercontinental outage will result in approximately 6,000 tonnes of reduced production. The Northwood outage will be extended to complete upgrades to the recovery boiler with an estimated 40,000 tonnes of reduced production, of which approximately 15,000 tonnes will fall in the second quarter with the balance in the third quarter.

On April 30, 2013, the Board of Directors declared a quarterly dividend of $0.05 per share, payable on May 21, 2013 to the shareholders of record on May 13, 2013.

**Ronald L. Cliff**
**Co - Chairman**

**Don B. Kayne**
**Chief Executive Officer**

**Michael J. Korenberg**
**Co - Chairman**

**Canfor Pulp Products Inc.**
**First Quarter 2013**
**Management's Discussion and Analysis**

*This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Pulp Products Inc.'s ("CPPI" or "the Company") financial performance for the quarter ended March 31, 2013 relative to the quarters ended December 31, 2012 and March 31, 2012, and the financial position of the Company at March 31, 2013. It should be read in conjunction with CPPI's unaudited interim consolidated financial statements and accompanying notes for the quarters ended March 31, 2013 and 2012, as well as the 2012 annual MD&A and the 2012 audited consolidated financial statements and notes thereto, which are included in CPPI's Annual Report for the year ended December 31, 2012 (available at www.canforpulp.com). The financial information in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.*

*Throughout this discussion, reference is made to operating income before amortization which CPPI considers to be a relevant indicator for measuring trends in the Company's performance and its ability to generate funds to meet its debt service and capital expenditure requirements, and to pay dividends. Operating income before amortization is not a generally accepted earnings measure and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating this measure, CPPI's operating income before amortization may not be directly comparable with similarly titled measures used by other companies. A reconciliation of operating income before amortization to operating income (loss) reported in accordance with IFRS is included in this MD&A.*

*Factors that could impact future operations are also discussed. These factors may be influenced by both known and unknown risks and uncertainties that could cause the actual results to be materially different from those stated in this discussion. Factors that could have a material impact on any future oriented statements made herein include, but are not limited to: general economic, market and business conditions; product selling prices; raw material and operating costs; currency exchange rates; interest rates; changes in law and public policy; the outcome of labour and trade disputes; and opportunities available to or pursued by CPPI.*

*All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at April 30, 2013.*

### *Forward Looking Statements*

*Certain statements in this MD&A constitute "forward-looking statements" which involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results, performance or achievements expressed or implied by such statements. Words such as "expects", "anticipates", "projects", "intends", "plans", "will", "believes", "seeks", "estimates", "should", "may", "could", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and actual events or results may differ materially. There are many factors that could cause such actual events or results expressed or implied by such forward-looking statements to differ materially from any future results expressed or implied by such statements. Forward-looking statements are based on current expectations and the Company assumes no obligation to update such information to reflect later events or developments, except as required by law.*

### CPPI SHARE EXCHANGE

On March 2, 2012, Canadian Forest Products Ltd. ("Canfor") acquired 35,776,483 common shares of Canfor Pulp Products, Inc. ("CPPI") in exchange for its 35,776,483 Class B Exchangeable LP Units of Canfor Pulp Limited Partnership ("the Partnership") and 35,776,483 common shares of Canfor Pulp Holding Inc. ("the General Partner"), pursuant to the terms of an Exchange Agreement made as of January 1, 2011 among Canfor, CPPI, the General Partner and the Partnership. 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. For the quarter ended March 31, 2012, and all subsequent quarters, the results of CPPI include the results of the Partnership.

### FIRST QUARTER 2013 OVERVIEW

Selected Financial Information and Statistics[1]

| (millions of Canadian dollars, except per share amounts) | Q1 2013 | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Operating income (loss) by segment: | | | |
| Pulp | **$ 15.4** | $ 7.8 | $ 12.2 |
| Paper | **$ 5.9** | $ 7.0 | $ 2.7 |
| Unallocated | **$ (2.3)** | $ (2.7) | $ (3.4) |
| **Total operating income** | **$ 19.0** | $ 12.1 | $ 11.5 |
| Add: Amortization | **$ 18.9** | $ 20.0 | $ 17.2 |
| **Total operating income before amortization** | **$ 37.9** | $ 32.1 | $ 28.7 |
| Add (deduct): | | | |
| Working capital movements | **$ (7.2)** | $ 2.4 | $ 14.4 |
| Defined benefit pension plan contributions | **$ (2.8)** | $ (2.4) | $ (2.6) |
| Other operating cash flows, net | **$ 0.4** | $ (6.3) | $ 1.0 |
| **Cash from operating activities** | **$ 28.3** | $ 25.8 | $ 41.5 |
| Add (deduct): | | | |
| Distributions / dividends paid | **$ (3.6)** | $ - | $ (7.8) |
| Finance expenses paid | **$ (0.2)** | $ (4.1) | $ (0.2) |
| Capital additions, net[2] | **$ (6.9)** | $ (11.5) | $ (18.6) |
| Acquisition of CPPI cash on exchange | **$ -** | $ - | $ 6.8 |
| Other, net | **$ 0.1** | $ - | $ 0.1 |
| **Change in cash / operating loans** | **$ 17.7** | $ 10.2 | $ 21.8 |
| **Average exchange rate (US$ per C$1.00)[3]** | **$ 0.991** | $ 1.009 | $ 0.999 |

[1] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the Company's unaudited interim consolidated financial statements.
[2] Additions to property, plant and equipment are shown net of amounts received under Government funding initiatives.
[3] Source – Bank of Canada (average noon rate for the period).

The Company reported operating income of $19.0 million for the first quarter of 2013, an increase of $6.9 million from operating income of $12.1[1] million reported for the fourth quarter of 2012. The increase primarily reflected modest gains in Northern Bleached Softwood Kraft ("NBSK") pulp sales realizations coupled with a reduction in unit manufacturing costs. Included in results were certain one-time items with the current quarter results including a non-cash $1.5 million benefit from scientific research and development tax credits while the previous quarter included a $5.3[1] million accounting gain related to amendments to the Company's salaried post retirement benefit plans.

Results in the first quarter of 2013 reflected a slight improvement in global softwood pulp markets resulting in prices slowly improving through the quarter. Global softwood pulp shipments and printing and writing demand were relatively flat compared to the previous quarter, with global softwood pulp producer inventory levels in March 2013 at 29 days supply, in line with the end of December 2012.

Compared to the previous quarter, the average NBSK pulp list price to North America increased US$34, or 4%, to US$897 per tonne. Sales to China and Europe were also up through the quarter, with pricing to China up US$16 per tonne and pricing to Europe up US$29 per tonne. Current quarter sales realizations did not match the full list price increases due to increased volumes into lower margin regions, principally China. A slight weakening of the Canadian dollar against the US dollar, down 2%, further contributed to improved Canadian dollar sales realizations.

Contributing to improved pulp segment results were a 5% increase in shipments from the previous quarter, principally reflecting higher volumes to China. Pulp production was up slightly from the previous quarter as a result of improved operating rates during the quarter. Unit manufacturing costs were down 3% from the previous quarter largely the result of lower maintenance costs coupled with the increased production levels, partially offset by seasonally higher energy costs and slightly higher fibre costs.

The Company's paper segment results decreased $1.1 million from the previous quarter, reflecting higher costs for slush pulp and lower sales realizations, mitigated slightly by higher shipment levels.

Compared to the first quarter of 2012, operating income improved by $7.5 million, equally reflecting increased pulp and paper segment earnings, and to a lesser extent a reduction in corporate costs. Higher pulp earnings largely reflected reduced unit manufacturing costs as well as increased energy sales. Pulp sales realizations remained broadly in line with the comparable period reflecting increased shipments to lower-margin regions, where list prices remained largely unchanged. A reduction in paper unit manufacturing costs coupled with increased paper production and shipments contributed to the improved paper segment results.

## OPERATING RESULTS BY BUSINESS SEGMENT

### Pulp

**Selected Financial Information and Statistics – Pulp[4]**

| (millions of Canadian dollars unless otherwise noted) | **Q1 2013** | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Sales | **$ 180.4** | $ 168.2 | $ 190.1 |
| Operating income before amortization | **$ 33.3** | $ 26.8 | $ 28.3 |
| Operating income | **$ 15.4** | $ 7.8 | $ 12.2 |
| Average pulp price delivered to U.S. – US$[5] | **$ 897** | $ 863 | $ 870 |
| Average price in Cdn$ | **$ 905** | $ 855 | $ 871 |
| Production – pulp (000 mt) | **264.5** | 260.5 | 261.7 |
| Shipments – pulp (000 mt) | **257.9** | 246.6 | 270.6 |
| Marketed on behalf of Canfor | **50.3** | 51.2 | 57.2 |

[4] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the Company's unaudited interim consolidated financial statements.
[5] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).

Overview

Operating income for the pulp segment was $15.4 million for the first quarter of 2013, an improvement of $7.6 million from the previous quarter and up $3.2 million from the first quarter of 2012. Improved pulp segment results compared to the previous quarter reflected a modest increase in pulp sales realizations coupled with a slight increase in pulp shipments, with increased volumes into China. Further contributing to the positive results was a 3% reduction in unit manufacturing costs largely reflecting reduced maintenance spending and to a lesser extent an increase in production volumes, offset in part by slightly higher fibre costs. Included in both quarters' results were certain one-time items: the current quarter results included a $1.5 million non-cash benefit from scientific research and development tax credits, while the fourth quarter of 2012 included a $4.4 million gain related to post retirement plan adjustments.

Higher operating earnings compared to the first quarter of 2012 reflected lower unit manufacturing costs as well as increased energy sales under the Energy Purchase Agreement ("EPA") at the Company's Prince George Pulp Mill.

Pulp sales realizations were broadly in line with the first quarter of 2012 as a 3% increase in the average North American NBSK pulp list price was offset by an increased volume of shipments to lower-margin regions, principally China. A reduction in fibre costs more than offset increased energy and maintenance spending (timing-related) compared to the first quarter of 2012. Other contributing factors included the aforementioned benefit from the scientific research and development tax credits.

Markets

Global softwood pulp markets showed a small improvement through the first quarter of 2013. Global softwood pulp shipments and printing and writing demand were relatively flat[6], with global softwood pulp producer inventory levels in March 2013 at 29 days supply, in line with the end of December 2012, and up 1 day compared to March 2012 inventories[7].

Sales

The Company's pulp shipments in the first quarter of 2013 were 258,000 tonnes, an increase of 11,000 tonnes, or 5%, from the previous quarter, principally reflecting higher shipment volumes to China. Compared to the first quarter of 2012, shipments were down 13,000 tonnes, or 5%, with the increased volumes to China more than offset by lower volumes to all other regions together with a 9,000 tonne drawdown of inventories in the first quarter of 2012.

Global softwood pulp markets saw modest price increases through the current quarter with average NBSK pulp list prices to all regions moving up US$15 to US$30 per tonne. The NBSK pulp list price to North America averaged US$897 per tonne for the quarter, up US$34, or 4%, from the previous quarter. Sales to China and Europe were also up through the quarter, with pricing to China up US$16 per tonne and pricing to Europe up US$29 per tonne. Current quarter sales realizations did not match the full list price increases due to increased volumes into lower-margin regions, principally China. Canadian dollar sales realizations further benefitted from a weakening of the Canadian dollar against the US dollar, which was down 2% compared to the previous quarter.

Compared to the first quarter of 2012, pulp sales realizations were largely unchanged, with a 3% gain in the average NBSK pulp list price to North America offset by increased volume to lower-margin regions. The North America average NBSK pulp list price increased US$27 per tonne from the previous quarter, while NBSK pulp list prices to China and Europe were in line with the same period in 2012. Higher energy sales under the EPA at the Company's Prince George Pulp Mill largely reflected improved operational performance in the current quarter. Sales realizations were also favourably impacted by the 1% weaker average Canadian dollar compared to the first quarter of 2012.

Operations

Pulp production in the current quarter was 264,500 tonnes, up marginally from the previous quarter, and in line with production in the first quarter of 2012. Production levels reflected steady improvements in operating rates through the quarter.

Pulp unit manufacturing costs decreased 3% from the previous quarter, driven by the timing of spending, in particular maintenance activities, coupled with the marginal increase in production levels, partially offset by seasonally higher energy costs. Fibre costs were up slightly compared to the previous quarter, reflecting a modest increase in sawmill residual chips, where prices are linked to NBSK pulp sales realizations, as well as a greater proportion of higher-cost whole log chips. The current quarter results also included a one-time non-cash $1.5 million benefit from scientific research and development tax credits.

Compared to the first quarter of 2012, unit manufacturing costs decreased 2% as lower fibre costs and the favourable impact of higher production volumes were partially offset by higher (timing-based) maintenance spending and higher energy costs.

[6] As reported by Pulp and Paper Products Council ("PPPC") statistics.
[7] World 20 data is based on twenty producing countries representing 80% of world chemical market pulp capacity and is based on information compiled and prepared by the PPPC.

**Paper**

**Selected Financial Information and Statistics – Paper**[8]

| (millions of Canadian dollars unless otherwise noted) | Q1 2013 | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Sales | **$ 36.1** | $ 33.7 | $ 29.9 |
| Operating income before amortization | **$ 6.9** | $ 8.0 | $ 3.7 |
| Operating income | **$ 5.9** | $ 7.0 | $ 2.7 |
| Production – paper (000 mt) | **34.8** | 35.4 | 32.9 |
| Shipments – paper (000 mt) | **35.0** | 32.0 | 29.6 |

[8] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the Company's unaudited interim consolidated financial statements.

## Overview

Operating income for the paper segment was $5.9 million for the first quarter of 2013, a decrease of $1.1 million from the previous quarter but up $3.2 million from the first quarter of 2012.

Compared to the fourth quarter of 2012, a 3% increase in unit manufacturing costs and lower realized paper prices were partially offset by higher shipments. Higher costs for slush pulp, in part reflecting higher market pulp prices, contributed to the increase in unit manufacturing costs which was mitigated somewhat by lower spending on operating and maintenance costs.

Compared to the first quarter of 2012, the improved results primarily reflected increased shipments and improved paper sales realizations coupled with reduced unit manufacturing costs.

### Markets

Global kraft paper market demand remained stagnant in the first quarter of 2013, with the extended winter conditions in Europe, the U.S. East Coast and Mid-West the main contributing factors. However, with customers' stocks at low levels, prices remained relatively stable through the quarter.

### Sales

The Company's paper shipments in the first quarter of 2013 were 35,000 tonnes, up 3,000 tonnes, or 9%, from the fourth quarter of 2012 and 5,400 tonnes, or 18%, higher than the first quarter of 2012. Prime bleached shipments, which attract higher prices, were up 7% from the previous quarter and up 23% from the first quarter of 2012.

Unit sales realizations for paper products were down slightly from the fourth quarter of 2012 in part reflecting a lower-value sales mix, which was partly offset by the weaker Canadian dollar. Paper sales realizations were up 4% from the comparable period in the prior year, mainly due to increased prime bleached product sales and a slightly weaker Canadian dollar.

### Operations

Paper production in the first quarter of 2013 was 34,800 tonnes, in line with the previous quarter. Production was up 1,900 tonnes compared to the first quarter of 2012, reflecting improved operating rates.

Paper unit manufacturing costs were up 3% from the previous quarter as a result of higher costs for slush pulp, principally reflecting higher market pulp prices partially offset by a reduction in operating and maintenance costs.

Compared to the first quarter of 2012, unit manufacturing costs were down, principally reflecting higher productivity in the current quarter.

**Unallocated Items**[9]

| (millions of Canadian dollars) | Q1 2013 | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Corporate costs | $ (2.3) | $ (2.7) | $ (3.4) |
| Finance expense, net | $ (3.1) | $ (3.7) | $ (3.2) |
| Foreign exchange gain (loss) on long-term debt | $ (2.3) | $ (1.3) | $ 2.0 |
| Gain (loss) on derivative financial instruments | $ 0.7 | $ (0.1) | $ 1.3 |
| Foreign exchange gain (loss) on working capital | $ 0.7 | $ 0.3 | $ (0.8) |

[9] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. Further details can be found in the Company's unaudited interim consolidated financial statements.

Corporate costs were $2.3 million for the first quarter of 2013, down slightly from the previous quarter and down $1.1 million from the first quarter of 2012. The decrease in the current quarter in part reflected lower incentive compensation costs and higher income from green energy attributes which are not allocated to segment results. Included in the fourth quarter of 2012 corporate costs was a portion of the accounting gain due to amendments to the Company's salaried post retirement benefit plans.

Net finance expense for the first quarter of 2013 was $3.1 million, down slightly from the previous quarter primarily reflecting costs in the fourth quarter of 2012 associated with a new operating facility. Net finance expense was in line with the first quarter of 2012. The finance expense for each period principally represents interest expense on long-term debt and stand-by fees for the Company's operating lines, as well as the finance expense relating to the Company's defined benefit post-retirement benefit plans.

The Company recorded a foreign exchange translation loss on its US dollar denominated debt of $2.3 million for the first quarter of 2013, as a result of the weakening of the Canadian dollar against the US dollar, which fell by just over 2% between the respective quarter ends. In the fourth quarter of 2012, the Company recorded a translation loss of $1.3 million, while the first quarter of 2012 showed a gain of $2.0 million.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs and interest rates. For the first quarter of 2013, the Company recorded a net gain of $0.7 million related to its derivative financial instruments, principally reflecting unrealized gains on US dollar collar contracts which will be settled in the second quarter of 2013.

The following table summarizes the gains (losses) on derivative financial instruments for the comparable periods:

| (millions of Canadian dollars) | Q1 2013 | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Foreign exchange collars and forward contracts | $ 0.7 | $ (0.2) | $ 1.2 |
| Crude oil collars | $ 0.1 | $ 0.1 | $ 0.1 |
| Interest rate swaps | $ (0.1) | $ - | $ - |
| | $ 0.7 | $ (0.1) | $ 1.3 |

**Other Comprehensive Income (Loss)**

In the first quarter of 2013, the Company recorded an after-tax credit to the statements of other comprehensive income (loss) of $0.2 million in relation to changes in the valuation of its defined benefit post-employment compensation plans. The gain reflects the return on plan assets offset by a slightly lower discount rate used to value the net defined benefit obligation. Defined benefit actuarial losses, net of taxes, were recorded in both the comparable periods, with an after-tax charge of $1.5 million in the fourth quarter of 2012 and an after-tax loss of $2.1 million in the first quarter of 2012.

## SUMMARY OF FINANCIAL POSITION

The following table summarizes CPPI's cash flow and selected ratios for and as at the end of the following periods:

| (millions of Canadian dollars, except for ratios) | Q1 2013 | Q4 2012 | Q1 2012 |
|---|---|---|---|
| Increase (decrease) in cash and cash equivalents | **$ 17.7** | $ 3.2 | $ 21.8 |
| Operating activities | **$ 28.3** | $ 25.8 | $ 41.5 |
| Financing activities | **$ (3.8)** | $ (11.1) | $ (8.0) |
| Investing activities | **$ (6.8)** | $ (11.5) | $ (11.7) |
| Ratio of current assets to current liabilities | **1.2 : 1** | 1.1 : 1 | 2.5 : 1 |
| Net debt to capitalization | **19.5%** | 22.2% | 18.2% |
| ROIC – Consolidated[10] | **3.0%** | 1.8% | 1.9% |

[10] Consolidated Return on Invested Capital ("ROIC") is equal to operating income/loss, plus realized gains/losses on derivatives and other income/expense, divided by the average invested capital during the year. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital.

### Changes in Financial Position

Cash generated from operating activities was $28.3 million in the first quarter of 2013, up $2.5 million from $25.8 million generated in the previous quarter. The increase resulted from higher operating earnings mostly offset by an increase in working capital balances. The decrease in cash generated from working capital movements principally related to higher accounts receivable balances reflecting the improved pricing and increased shipments in the current quarter partly offset by an increase in accounts payable largely reflecting the timing of payments, in particular property taxes. Compared to the first quarter of 2012, cash generated from operating activities was down by $13.2 million, principally reflecting higher accounts receivable balances, partly offset by higher cash earnings in the current quarter.

Financing activities used cash of $3.8 million in the current quarter, compared to $11.1 million in the previous quarter and $8.0 million in the first quarter of 2012. Cash flows in the current period included a $3.6 million dividend declared and paid. In the first quarter of 2012, distributions paid to unitholders were $7.8 million. The previous quarter cash flows also included a $7.0 million repayment on the Company's operating bank loans. Finance payments in the current quarter were $0.2 million, in line with the same quarter in 2012, while finance payments in the previous quarter were $4.1 million principally relating to interest payments on the Company's debt.

Cash used in investing activities of $6.8 million in the current quarter principally related to equipment being built for the turbine upgrades at the Company's Northwood Pulp Mill planned for late 2013.

### Liquidity and Financial Requirements

At March 31, 2013, CPPI had cash of $16.5 million and an operating loan facility of $110.0 million which was unused, except for $2.2 million reserved for several standby letters of credit. In addition, 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 under a power generation agreement.

CPPI has US$110.0 million of senior debt that is scheduled for repayment on November 30, 2013. This debt is in the form of unsecured US dollar private placement notes and bears interest at 6.41%.

The Company remained in compliance with the covenants relating to its operating loans and long-term debt during the quarter, and expects to remain so for the foreseeable future.

### Dividends

On April 30, 2013, the Board of Directors declared a quarterly dividend of $0.05 per share, payable on May 21, 2013 to the shareholders of record on May 13, 2013.

## OUTLOOK

### Pulp

NBSK pulp markets are projected to remain fairly challenging through the second quarter of 2013, but annual spring maintenance downtime should allow for modest price increases. The outlook for the second half of the year is more uncertain given the new hardwood and softwood pulp capacity projected to come online. For the month of April, the Company announced an increase in the North American NBSK pulp list price of US$30 per tonne to US$930.

Maintenance outages are planned at the Intercontinental and Northwood Pulp Mills during the second quarter of 2013. The Intercontinental outage will result in approximately 6,000 tonnes of reduced production. The Northwood outage will be extended to complete upgrades to the recovery boiler with an estimated 40,000 tonnes of reduced production, of which approximately 15,000 tonnes will fall in the second quarter with the balance in the third quarter.

The Company will be completing the installation of a new precipitator at the Prince George Pulp Mill and upgrades to both Northwood turbines during the fourth quarter of 2013. Incremental power generated will be used to displace electricity purchases and meet existing power sale commitments.

### Paper

Kraft paper demand is slow heading into the second quarter and order files are light. However, customer inventories remain low and demand is projected to show some improvement in the coming months. Prices for bleached and unbleached papers in North America and Europe are projected to remain flat through the second quarter of 2013.

## OUTSTANDING SHARES

At April 30, 2013, there were 71,269,790 common shares outstanding.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect the amounts recorded in the financial statements. On an ongoing basis, management reviews its estimates, including those related to useful lives for amortization, impairment of long-lived assets, pension and other employee future benefit plans and asset retirement obligations based upon currently available information. While it is reasonably possible that circumstances may arise which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect the Company's financial condition.

## CHANGES IN ACCOUNTING POLICIES

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

- The Company has assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10, *Consolidated Financial Statements,* did not result in any changes in the consolidation status of any of its subsidiaries and investees.

- The Company has adopted IFRS 13, *Fair Value Measurement,* on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

- The Company has reviewed the classification of its joint arrangements and concluded that the adoption of IFRS 11, *Joint Arrangements,* did not result in any changes in the accounting for its joint arrangements.

- The Company has adopted the amendments to IAS 1, *Presentation of Financial Statements,* effective January 1, 2013. These amendments required the Company to group other comprehensive income items by those that may be recycled through net income and those that will not be recycled through net income. These changes did not result in any adjustments to other comprehensive income.

- The Company adopted amended IAS 19, *Employee Benefits* which changes the recognition and measurement of defined benefit pension expense and termination benefits and enhances the disclosure of all employee benefits. Pension benefit cost is 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 previously reflected different rates, has been replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset).

  The effect on the consolidated balance sheet as at December 31, 2012, as a result of the adoption of IAS 19, was a decrease in the retirement benefit obligations of $1.2 million and an increase in deferred tax liability of $0.3 million.

  The effect on the consolidated income statement for the three months ended March 31, 2012 was an increase in finance expense of $0.4 million and a decrease in the net income of $0.3 million.

  The effect on the consolidated statement of other comprehensive income (loss) for three months ended March 31, 2012 was a decrease in defined benefit plan actuarial losses of $0.3 million.

## ACCOUNTING STANDARDS ISSUED AND NOT APPLIED

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments,* which is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

Further details of the new accounting Standard and potential impact on CPPI can be found in the Company's Annual Report for the year ended December 31, 2012.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended March 31, 2013, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

## RISKS AND UNCERTAINTIES

A comprehensive discussion of risks and uncertainties is included in the Company's 2012 annual statutory reports which are available on www.canforpulp.com or www.sedar.com.

## SELECTED QUARTERLY FINANCIAL INFORMATION[11]

| | Q1 2013 | Q4 2012 | Q3 2012 | Q2 2012 | Q1 2012 | Q4 2011 | Q3 2011 | Q2 2011 |
|---|---|---|---|---|---|---|---|---|
| **Sales and income** (millions of Canadian dollars) | | | | | | | | |
| Sales | **$ 217.5** | $ 201.9 | $ 177.7 | $ 210.8 | $ 220.0 | $ 212.7 | $ 233.9 | $ 242.1 |
| Operating income before amortization | **$ 37.9** | $ 32.1 | $ 6.9 | $ 25.0 | $ 28.7 | $ 37.9 | $ 50.3 | $ 64.8 |
| Operating income (loss) | **$ 19.0** | $ 12.1 | $ (8.3) | $ 10.3 | $ 11.5 | $ 16.5 | $ 36.4 | $ 49.8 |
| Net income (loss) | **$ 10.9** | $ 5.4 | $ (5.0) | $ 3.0 | $ 10.0 | $ 15.8 | $ 23.9 | $ 48.2 |
| **Per common share** (dollars) | | | | | | | | |
| Net income (loss) – basic and diluted | **$ 0.15** | $ 0.08 | $ (0.07) | $ 0.04 | $ 0.12 | $ 0.22 | $ 0.33 | $ 0.68 |
| **Statistics** | | | | | | | | |
| Pulp shipments (000 mt) | **257.9** | 246.6 | 214.4 | 230.2 | 270.6 | 231.0 | 240.2 | 242.0 |
| Paper shipments (000 mt) | **35.0** | 32.0 | 30.6 | 36.8 | 29.6 | 30.2 | 32.1 | 32.7 |
| Average exchange rate – US$/Cdn$ | **$ 0.991** | $ 1.009 | $ 1.005 | $ 0.990 | $ 0.999 | $ 0.977 | $ 1.020 | $ 1.033 |
| Average NBSK pulp list price delivered to U.S. (US$) | **$ 897** | $ 863 | $ 853 | $ 900 | $ 870 | $ 920 | $ 993 | $ 1,025 |

[11] Certain prior period amounts have been restated due to the adoption of amended IAS 19, *Employee Benefits*. 2011 amounts have not been restated. Further details can be found in the Company's unaudited interim consolidated financial statements.

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

**Canfor Pulp Products Inc.**
**Condensed Consolidated Balance Sheets**

| (millions of Canadian dollars, unaudited) | | As at March 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| **ASSETS** | | | | (Note 1) |
| **Current assets** | | | | |
| Cash and cash equivalents | **$** | **16.5** | $ | - |
| Accounts receivable - Trade (Note 10) | | **70.7** | | 61.6 |
| - Other | | **23.4** | | 22.8 |
| Inventories (Note 2) | | **134.4** | | 134.1 |
| Prepaid expenses and other assets | | **7.1** | | 8.3 |
| Total current assets | | **252.1** | | 226.8 |
| **Property, plant and equipment** | | **521.9** | | 530.8 |
| **Other long-term assets** | | **1.9** | | 0.4 |
| **Total assets** | **$** | **775.9** | $ | 758.0 |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Cheques issued in excess of cash on hand | **$** | **-** | $ | 1.2 |
| Accounts payable and accrued liabilities | | **104.6** | | 93.4 |
| Current portion of long-term debt (Note 3(b)) | | **111.7** | | 109.4 |
| Total current liabilities | | **216.3** | | 204.0 |
| **Retirement benefit obligations** | | **103.1** | | 103.9 |
| **Other long-term provisions** | | **3.6** | | 3.6 |
| **Deferred income taxes, net** | | **58.8** | | 59.9 |
| **Total liabilities** | **$** | **381.8** | $ | 371.4 |
| **EQUITY** | | | | |
| Share capital | **$** | **525.3** | $ | 525.3 |
| Retained earnings (deficit) | | **(131.2)** | | (138.7) |
| **Total equity** | **$** | **394.1** | $ | 386.6 |
| **Total liabilities and equity** | **$** | **775.9** | $ | 758.0 |

**Subsequent Event** (Note 13)

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

APPROVED BY THE BOARD

S.E. Bracken-Horrocks

R. Lawrence Cliff

Director, S.E. Bracken-Horrocks

Director, R.L. Cliff

## Canfor Pulp Products Inc.
## Condensed Consolidated Statements of Income (Loss)

| (millions of Canadian dollars, unaudited) | 3 months ended March 31, 2013 | 2012 (Note 1) |
|---|---|---|
| **Sales** | **$ 217.5** | $ 220.0 |
| **Costs and expenses** | | |
| Manufacturing and product costs | **143.3** | 153.1 |
| Freight and other distribution costs | **30.9** | 32.1 |
| Amortization | **18.9** | 17.2 |
| Selling and administration costs | **5.4** | 6.1 |
| | **198.5** | 208.5 |
| **Operating income** | **19.0** | 11.5 |
| Finance expense, net | **(3.1)** | (3.2) |
| Foreign exchange gain (loss) on long-term debt | **(2.3)** | 2.0 |
| Gain on derivative financial instruments (Note 5) | **0.7** | 1.3 |
| Foreign exchange gain (loss) on working capital | **0.7** | (0.8) |
| Net income before income taxes | **15.0** | 10.8 |
| Income tax expense (Note 6) | **(4.1)** | (0.8) |
| **Net income** | **$ 10.9** | $ 10.0 |
| **Net income attributable to:** | | |
| Controlling interest in the Partnership | **$ 10.9** | $ 5.7 |
| Non-controlling interest in the Partnership (Note 11) | **-** | 4.3 |
| **Net income** | **$ 10.9** | $ 10.0 |
| **Net income per common share:** (in dollars) | | |
| Attributable to controlling interest in the Partnership | | |
| - Basic and diluted (Note 7) | **$ 0.15** | $ 0.12 |

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

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

| (millions of Canadian dollars, unaudited) | 3 months ended March 31, 2013 | 2012 (Note 1) |
|---|---|---|
| **Net income** | **$ 10.9** | $ 10.0 |
| **Other comprehensive income (loss)** | | |
| Items that will not be recycled through net income: | | |
| Defined benefit plan actuarial gains (losses) (Note 4) | **0.3** | (2.8) |
| Income tax recovery (expense) on defined benefit plan actuarial (gains) losses (Note 6) | **(0.1)** | 0.7 |
| Other comprehensive income (loss), net of tax | **0.2** | (2.1) |
| **Total comprehensive income** | **$ 11.1** | $ 7.9 |
| | | |
| **Total comprehensive income attributable to:** | | |
| Controlling interest in the Partnership | **$ 11.1** | $ 3.6 |
| Non-controlling interests in the Partnership (Note 11) | **-** | 4.3 |
| **Total comprehensive income** | **$ 11.1** | $ 7.9 |

## Condensed Consolidated Statements of Changes in Equity

| (millions of Canadian dollars, unaudited) | 3 months ended March 31, 2013 | 2012 (Note 1) |
|---|---|---|
| **Share capital** | | |
| Balance at beginning of period | **$ 525.3** | $ 294.9 |
| Exchange transaction (Note 11) | **-** | 230.4 |
| Balance at end of period | **$ 525.3** | $ 525.3 |
| **Retained earnings (deficit)** | | |
| Balance at beginning of period | **$ (138.7)** | $ (67.3) |
| Exchange transaction (Note 11) | **-** | (57.8) |
| Net income excluding amount attributable to non-controlling interests in the Partnership | **10.9** | 5.7 |
| Defined benefit plan actuarial gains (losses), net of tax | **0.2** | (2.1) |
| Dividends declared | **(3.6)** | - |
| Balance at end of period | **$ (131.2)** | $ (121.5) |
| **Total equity attributable to equity holders of the Company** | **$ 394.1** | $ 403.8 |
| **Non-controlling interests in the Partnership** | | |
| Balance at beginning of period | **$ -** | $ 226.1 |
| Net income attributable to non-controlling interests in the Partnership | **-** | 4.3 |
| Exchange transaction (Note 11) | **-** | (230.4) |
| Balance at end of period | **$ -** | $ - |
| **Total equity** | **$ 394.1** | $ 403.8 |

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

## Canfor Pulp Products Inc.
## Condensed Consolidated Statements of Cash Flows

| (millions of Canadian dollars, unaudited) | 3 months ended March 31, 2013 | 2012 (Note 1) |
|---|---|---|
| **Cash generated from (used in):** | | |
| **Operating activities** | | |
| Net income | **$ 10.9** | $ 10.0 |
| Items not affecting cash: | | |
| Amortization | **18.9** | 17.2 |
| Income tax expense | **4.1** | 0.8 |
| Foreign exchange (gain) loss on long-term debt | **2.3** | (2.0) |
| Changes in mark-to-market value of derivative financial instruments | **(0.6)** | 0.4 |
| Employee future benefits | **1.4** | 1.3 |
| Net finance expense | **3.1** | 3.2 |
| Other, net | **(1.8)** | - |
| Defined benefit pension plan contributions | **(2.8)** | (2.6) |
| Income taxes paid, net | **-** | (1.2) |
| Net change in non-cash working capital (Note 8) | **(7.2)** | 14.4 |
| | **28.3** | 41.5 |
| **Financing activities** | | |
| Finance expenses paid | **(0.2)** | (0.2) |
| Dividends / distributions paid | **(3.6)** | (7.8) |
| | **(3.8)** | (8.0) |
| **Investing activities** | | |
| Additions to property, plant and equipment | **(6.9)** | (25.6) |
| Expenditures under Green Transformation Program | **-** | (1.1) |
| Reimbursements under Green Transformation Program | **-** | 7.9 |
| Other government grants received | **-** | 0.2 |
| Acquisition of CPPI cash on exchange (Note 11) | **-** | 6.8 |
| Other, net | **0.1** | 0.1 |
| | **(6.8)** | (11.7) |
| **Increase in cash and cash equivalents*** | **17.7** | 21.8 |
| Cash and cash equivalents at beginning of period* | **(1.2)** | (2.0) |
| **Cash and cash equivalents at end of period*** | **$ 16.5** | $ 19.8 |

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

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

## 1. Basis of Preparation

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*, and include the accounts of Canfor Pulp Products Inc. ("CPPI") 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. 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 11).

At March 31, 2013, CPPI held a 100% interest in the Partnership and the General Partner and Canfor held a 50.2% interest in CPPI. The condensed consolidated interim financial statements ("the financial statements") at March 31, 2013 include the accounts of CPPI, the Partnership and its subsidiaries (together referred to as "CPPI" or "the Company").

These interim financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for annual financial statements. Additional disclosures relevant to the understanding of these interim financial statements, including the accounting policies applied, can be found in the Company's Annual Report for the year ended December 31, 2012, available at www.canforpulp.com or www.sedar.com.

The currency of presentation for these financial statements is the Canadian dollar.

### *Changes in Accounting Policies*

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

- The Company has assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10, *Consolidated Financial Statements,* did not result in any changes in the consolidation status of any of its subsidiaries and investees.

- The Company has adopted IFRS 13, *Fair Value Measurement,* on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

- The Company has reviewed the classification of its joint arrangements and concluded that the adoption of IFRS 11, *Joint Arrangements,* did not result in any changes in the accounting for its joint arrangements.

- The Company has adopted the amendments to IAS 1, *Presentation of Financial Statements*. These amendments required the Company to group other comprehensive income items by those that may be recycled through net income and those that will not be recycled through net income. These changes did not result in any adjustments to other comprehensive income.

- The Company adopted amended IAS 19, *Employee Benefits,* which changes the recognition and measurement of defined benefit pension expense and termination benefits and enhances the disclosure of all employee benefits. Pension benefit cost is 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 previously reflected different rates, has been replaced with a net interest amount that is calculated by applying one discount rate to the net defined benefit liability (asset).

The effect on the consolidated balance sheet as at December 31, 2012, as a result of the adoption of amended IAS 19, was a decrease in retirement benefit obligations of $1.2 million and an increase in deferred tax liability of $0.3 million.

The effect on the consolidated income statement for the three months ended March 31, 2012 was an increase in finance expense of $0.4 million and a decrease in the net income of $0.3 million.

The effect on the consolidated statement of other comprehensive income (loss) for the three months ended March 31, 2012 was a decrease in defined benefit plan actuarial losses of $0.3 million (after tax).

***Accounting Standards Issued and Not Applied***

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments,* which is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. IFRS 9 is not expected to have a material impact on amounts recorded in the financial statements of CPPI.

Further details of the new accounting Standard and potential impact on CPPI can be found in the Company's Annual Report for the year ended December 31, 2012.

## 2. Inventories

| (millions of Canadian dollars) | | **As at March 31, 2013** | | As at December 31, 2012 |
|---|---|---|---|---|
| Pulp | **$** | **63.3** | $ | 59.4 |
| Paper | | **17.6** | | 18.2 |
| Wood chips | | **7.4** | | 10.9 |
| Materials and supplies | | **46.1** | | 45.6 |
| | **$** | **134.4** | $ | 134.1 |

## 3. Operating Loans and Long-Term Debt

***(a) Available Operating Loans***

| (millions of Canadian dollars) | | **As at March 31, 2013** | | As at December 31, 2012 |
|---|---|---|---|---|
| Operating loan facility | **$** | **110.0** | $ | 110.0 |
| Facility for BC Hydro letter of credit | | **7.5** | | 7.5 |
| Total operating loans | | **117.5** | | 117.5 |
| Letters of credit (for general business purposes) | | **(2.2)** | | (1.7) |
| BC Hydro letter of credit | | **(7.5)** | | (7.5) |
| Total available operating loans | **$** | **107.8** | $ | 108.3 |

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, depreciation, amortization and certain other non-cash items, and is based on the lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. In addition, the 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 this facility is November 13, 2016.

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 March 31, 2013, the Company was in compliance with all covenants relating to its operating loans.

### *(b) Long-Term Debt*

At March 31, 2013, the fair value of the Company's long-term debt, which was measured at its amortized cost of $111.7 million (US$110.0 million), was $115.3 million. The fair value was determined based on prevailing market rates for long-term debt with similar characteristics and risk profile.

## 4. Employee Future Benefits

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. At the end of each interim reporting period, the Company estimates movements in its accrued benefit liabilities based upon movements in discount rates and the rates of return on plan assets, as well as any significant changes to the plans. Adjustments are also made for payments made and current service and interest costs.

For the three months ended March 31, 2013, an amount of $0.3 million (before tax) was credited to other comprehensive income. The gain reflects the return on plan assets offset by a slightly lower discount rate used to value the net defined benefit obligation. For the three months ended March 31, 2012, an amount of $2.8 million (before tax) was charged to other comprehensive income.

For the Company's single largest pension plan, 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.

The assumptions used to estimate the changes in net accrued benefit liabilities were as follows:

| | |
|---|---|
| **Pension Benefit Plans** | |
| Discount rate | |
| March 31, 2013 | **4.10%** |
| December 31, 2012 | 4.20% |
| March 31, 2012 | 4.80% |
| December 31, 2011 | 5.00% |
| Rate of return on plan assets | |
| 3 months ended March 31, 2013 | **4.00%** |
| 3 months ended March 31, 2012 | 4.30% |
| **Other Benefit Plans** | |
| Discount rate | |
| March 31, 2013 | **4.30%** |
| December 31, 2012 | 4.40% |
| March 31, 2012 | 5.00% |
| December 31, 2011 | 5.30% |

## 5. 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 13, *Fair Value Measurement,* 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 March 31, 2013 and December 31, 2012, 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 March 31, 2013** | | As at December 31, 2012 |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Held for trading | | | | | |
| Derivative financial instruments | Level 2 | **$** | **0.8** | $ | 0.1 |
| Loans and receivables | | | | | |
| Cash and cash equivalents | n/a | | **16.5** | | - |
| Accounts receivable (excluding derivatives) | n/a | | **93.3** | | 84.3 |
| | | **$** | **110.6** | $ | 84.4 |
| **Financial liabilities** | | | | | |
| Held for trading | | | | | |
| Derivative financial instruments | Level 2 | **$** | **0.1** | $ | - |
| Other liabilities | | | | | |
| Cheques issued in excess of cash on hand | n/a | | **-** | | 1.2 |
| Accounts payable and accrued liabilities (excluding derivatives) | n/a | | **104.5** | | 93.4 |
| Long-term debt (including current portion) | n/a | | **111.7** | | 109.4 |
| | | **$** | **216.3** | $ | 204.0 |

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 March 31, 2013, the fair value of derivative financial instruments was a net asset of $0.7 million (December 31, 2012 – net asset of $0.1 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 three month periods ended March 31, 2013 and 2012:

| | 3 months ended March 31, | | | |
|---|---|---|---|---|
| (millions of Canadian dollars) | | **2013** | | 2012 |
| Foreign exchange collars and forward contracts | **$** | **0.7** | $ | 1.2 |
| Crude oil collars | | **0.1** | | 0.1 |
| Interest rate swaps | | **(0.1)** | | - |
| | **$** | **0.7** | $ | 1.3 |

The following table summarizes the fair value of the derivative financial instruments included in the balance sheet at March 31, 2013 and December 31, 2012:

| (millions of Canadian dollars) | | **As at March 31, 2013** | | As at December 31, 2012 |
|---|---|---|---|---|
| Foreign exchange collars and forward contracts | **$** | **0.7** | $ | - |
| Crude oil collars | | **0.1** | | 0.1 |
| Interest rate swaps | | **(0.1)** | | - |
| Total current asset, net | **$** | **0.7** | $ | 0.1 |

## 6. Income Taxes

Income tax expense for the three months ended March 31, 2012 includes current tax expense on income subsequent to the exchange on March 2, 2012. Prior to the Exchange, taxes were minimal reflecting the non-taxable status of the Partnership (Note 11).

| | | 3 months ended March 31, | | |
|---|---|---|---|---|
| (millions of Canadian dollars) | | **2013** | | 2012 |
| Current | **$** | **(5.3)** | $ | (1.7) |
| Deferred | | **1.2** | | 0.9 |
| Income tax expense | **$** | **(4.1)** | $ | (0.8) |

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

| | | 3 months ended March 31, | | |
|---|---|---|---|---|
| (millions of Canadian dollars) | | **2013** | | 2012 |
| Income tax expense at statutory rate 2013 – 25.0% (2012 – 25.0%) | **$** | **(3.8)** | $ | (2.7) |
| Add (deduct): | | | | |
| Permanent difference from capital gains and other non-deductible items | | **(0.3)** | | 0.1 |
| Permanent difference – exchange transaction | | **-** | | 0.9 |
| Tax included in equity – exchange transaction | | **-** | | 0.9 |
| Income tax expense | **$** | **(4.1)** | $ | (0.8) |

In addition to the amounts recorded to net income, a tax expense of $0.1 million was recorded to other comprehensive income for the three month period ended March 31, 2013 (three months ended March 31, 2012 – recovery of $0.7 million) in relation to the actuarial gains (losses) on defined benefit employee compensation plans.

## 7. 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. As a result of the exchange transaction and the application of reverse acquisition accounting, the CPPI shares relating to the non-controlling interest shareholders were not included until March 2, 2012. This transaction led to an increase in the weighted average number of shares outstanding. The issuance of the new shares as a result of the exchange was accompanied by a corresponding increase in CPPI's investment in the Partnership and as a result there is no dilution of CPPI's net income per share.

| | 3 months ended March 31, | |
|---|---|---|
| | **2013** | 2012 |
| Weighted average number of common shares | **71,269,790** | 47,087,537 |

## 8. Net Change in Non-Cash Working Capital

| | | 3 months ended March 31, | | |
|---|---|---|---|---|
| (millions of Canadian dollars) | | **2013** | | 2012 |
| Accounts receivable | **$** | **(14.1)** | $ | 7.1 |
| Inventories | | **(0.3)** | | 7.4 |
| Prepaid expenses and other assets | | **1.2** | | (0.2) |
| Accounts payable and accrued liabilities | | **6.0** | | 0.1 |
| Net decrease (increase) in non-cash working capital | **$** | **(7.2)** | $ | 14.4 |

## 9. 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.

| (millions of Canadian dollars) | | Pulp | Paper | Unallocated | Elimination Adjustment | | Consolidated |
|---|---|---|---|---|---|---|---|
| **3 months ended March 31, 2013** | | | | | | | |
| **Sales to external customers** | **$** | **180.4** | **36.1** | **1.0** | **-** | **$** | **217.5** |
| **Sales to other segments** | **$** | **18.1** | **-** | **-** | **(18.1)** | **$** | **-** |
| **Operating income (loss)** | **$** | **15.4** | **5.9** | **(2.3)** | **-** | **$** | **19.0** |
| **Amortization** | **$** | **17.9** | **1.0** | **-** | **-** | **$** | **18.9** |
| **Capital expenditures** | **$** | **6.6** | **0.2** | **0.1** | **-** | **$** | **6.9** |
| **Identifiable assets** | **$** | **671.5** | **64.4** | **40.0** | **-** | **$** | **775.9** |
| 3 months ended March 31, 2012 | | | | | | | |
| Sales to external customers | $ | 190.1 | 29.9 | - | - | $ | 220.0 |
| Sales to other segments | $ | 17.2 | - | - | (17.2) | $ | - |
| Operating income (loss) | $ | 12.2 | 2.7 | (3.4) | - | $ | 11.5 |
| Amortization | $ | 16.1 | 1.0 | 0.1 | - | $ | 17.2 |
| Capital expenditures[1] | $ | 26.4 | 0.1 | 0.2 | - | $ | 26.7 |
| Identifiable assets | $ | 677.7 | 65.5 | 37.1 | - | $ | 780.3 |

[1] Capital expenditures represent cash paid for capital assets during the period. For 2012, capital expenditures includes amounts that are financed by the federal government-funded Green Transportation Program.

## 10. Related Party Transactions

The Company depends on Canfor to provide approximately 63% (2012 – 58%) of its fibre supply as well as to provide certain key business and administrative services. As a result of these relationships the Company considers its operations to be dependent on its ongoing relationship with Canfor.

The transactions with Canfor are consistent with the transactions described in the December 31, 2012 audited consolidated financial statements of CPPI and the Partnership and are based on agreed upon amounts between the parties. Transactions and payables to Canfor include purchases of wood chips, pulp and administrative services. These are summarized below:

| (millions of Canadian dollars) | | 3 months ended March 31, **2013** | | 2012 |
|---|---|---|---|---|
| **Transactions** | | | | |
| Canfor – purchase of wood chips and other | **$** | **31.3** | $ | 28.3 |

| (millions of Canadian dollars) | | **As at March 31, 2013** | | As at December 31, 2012 |
|---|---|---|---|---|
| **Balance Sheet** | | | | |
| Included in accounts payable and accrued liabilities: | | | | |
| Canfor | **$** | **15.4** | $ | 12.9 |
| Included in trade and other accounts receivable: | | | | |
| Products marketed for Canfor | **$** | **2.8** | $ | 4.4 |
| Canfor[1] | | **5.0** | | 3.0 |

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

## 11. Acquisition of Interest in Canfor Pulp Limited Partnership

In the first quarter of 2012, as a result of the Exchange described in Note 1, CPPI increased its interest in both the Partnership and the General Partner 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 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 three months ended March 30, 2012. Canfor's interest in the Pulp Business was deemed to acquire CPPI on March 2, 2012 and the non-controlling interest was eliminated on that date.

Management estimated that the fair value of CPPI's assets and liabilities approximated 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) |

## 12. Insurance Claim Receivable

During the second quarter of 2012, an incident at the Northwood Pulp Mill resulted in an unscheduled shutdown and subsequent repairs of the recovery boiler. The Company recognized a property damage insurance receivable of $5.6 million, which substantially offset the additional maintenance costs related to this incident. In addition, 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 lost production.

As at March 31, 2013, the total insurance receivable amount, net of advances received, of $6.3 million is included within Other Accounts Receivable.

## 13. Subsequent Event

On April 30, 2013, the Board of Directors declared a quarterly dividend of $0.05 per share, payable on May 21, 2013 to shareholders of record on May 13, 2013.