

CANFOR PULP INCOME FUND

CANFOR PULP LIMITED PARTNERSHIP

Unaudited Interim Consolidated Financial Statements

For the three and six months ended June 30, 2009

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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Income (loss)				
Equity income (loss) in Canfor Pulp Limited Partnership	\$ 724	\$ 9,046	\$ (10,016)	\$ 30,713
Net income (loss) before future income taxes	724	9,046	(10,016)	30,713
Future income taxes (recovery) (note 6)	(3,682)	2,031	(3,682)	2,031
Net income (loss)	4,406	7,015	(6,334)	28,682
Distributions declared (note 4)	(1,065)	(12,777)	(3,195)	(25,555)
Earnings in excess of distributions – surplus (deficit)	\$ 3,341	\$ (5,762)	\$ (9,529)	\$ 3,127
Net income (loss) per unit, basic and diluted	\$ 0.12	\$ 0.20	\$ (0.30)	\$ 0.81
Weighted average number of units	35,493,505	35,493,505	35,493,505	35,493,524
Net income (loss) for the period	\$ 4,406	7,015	(6,334)	28,682
Equity interest in other comprehensive loss of Canfor Pulp Limited Partnership	(9)	(126)	(30)	(181)
Comprehensive income (loss)	\$ 4,397	\$ 6,889	\$ (6,364)	\$ 28,501
Accumulated Earnings and Distributions				
Balance, beginning of period – distributions in excess of earnings	\$ (85,733)	\$ (35,907)	\$ (72,863)	\$ (44,796)
Earnings in excess of distributions – surplus (deficit), current period	\$ 3,341	\$ (5,762)	\$ (9,529)	\$ 3,127
Balance, end of period – Accumulated distributions in excess of earnings	\$ (82,392)	\$ (41,669)	\$ (82,392)	\$ (41,669)

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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Cash generated from (used in)				
Operating activities				
Net income (loss)	\$ 4,406	\$ 7,015	\$ (6,334)	\$ 28,682
Items not affecting cash:				
Equity (income) loss in Canfor Pulp Limited Partnership	(724)	(9,046)	10,016	(30,713)
Future income taxes (recovery)	(3,682)	2,031	(3,682)	2,031
Distributions received from Canfor Pulp Limited Partnership	1,065	12,777	4,259	25,555
	1,065	12,777	4,259	25,555
Financing activities				
Distributions paid to Unitholders	\$ (1,065)	\$ (12,777)	\$ (4,259)	\$ (25,555)
Beginning, change and ending balance in cash and cash equivalents	\$ -	\$ -	\$ -	\$ -

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, 2009	As at December 31, 2008
ASSETS		
Current assets		
Distributions receivable from Canfor Pulp Limited Partnership (notes 4,5)	\$ 355	\$ 1,420
Total current assets	355	1,420
Equity investment in Canfor Pulp Limited Partnership (note 3)	253,033	266,274
	\$ 253,388	\$ 267,694
LIABILITIES		
Current liabilities		
Distributions payable (note 4)	\$ 355	\$ 1,420
Total current liabilities	355	1,420
Future income taxes (note 6)	36,027	39,709
	\$ 36,382	\$ 41,129
UNITHOLDERS' EQUITY		
Unitholders' equity – 35,493,505 Fund units outstanding	\$ 299,351	\$ 299,351
Accumulated earnings and distributions	(82,392)	(72,863)
Accumulated other comprehensive income (note 7)	47	77
Total Unitholders' Equity	217,006	226,565
	\$ 253,388	\$ 267,694

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, 2009

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

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

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 2008 Annual Report available at www.canforpulp.com or www.sedar.com. These unaudited interim consolidated financial statements follow the same accounting policies and methods of computation as used in the 2008 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, 2009	Year ended December 31, 2008
Balance, beginning of period	266,274	291,458
Equity interest in income (loss) of the Partnership	(10,016)	23,280
Equity interest in other comprehensive loss of the Partnership	(30)	(193)
Distributions from the Partnership	(3,195)	(48,271)
Balance, end of period	253,033	266,274

4. Distributions

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

(thousands of dollars, except per unit amounts, unaudited)		Amount per Fund Unit	Amount
Record Date	Payable Date	\$	\$
January 30, 2009	February 13, 2009	0.04	1,420
February 27, 2009	March 13, 2009	0.01	355
March 31, 2009	April 15, 2009	0.01	355
April 30, 2009	May 15, 2009	0.01	355
May 29, 2009	June 15, 2009	0.01	355
June 30, 2009	July 15, 2009	0.01	355
		0.09	3,195

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, 2009 were \$1.1 million of which \$0.7 million was received, with the balance of \$0.4 million receivable on June 30, 2009.

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, 2009	Year ended December 31, 2008
Expected income tax expense at statutory tax rate of nil (2008 – nil)	-	-
Future income taxes (recovery) on temporary differences	(3,682)	3,076
	(3,682)	3,076

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

(thousands of dollars, unaudited)	June 30, 2009	December 31, 2008
Future income tax liability:		
Equity investment in the Partnership	43,682	44,453
Expected reversal of temporary differences prior to 2011	(7,655)	(4,744)
	36,027	39,709

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

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, 2009	Year ended December 31, 2008
Balance, beginning of period	77	270
Other comprehensive loss	(30)	(193)
Balance, end of period	47	77

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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Revenue				
Sales	\$ 205.0	\$ 212.6	\$ 391.3	\$ 424.0
Business interruption insurance	3.2	3.3	3.2	14.7
	208.2	215.9	394.5	438.7
Costs and expenses				
Manufacturing and product costs	162.3	159.0	312.1	307.9
Freight and other distribution costs	32.1	27.2	60.9	52.5
Amortization	12.2	12.0	24.2	23.6
Selling and administration costs	6.6	6.1	12.1	12.5
	213.2	204.3	409.3	396.5
Operating income (loss)	(5.0)	11.6	(14.8)	42.2
Net property damage insurance gain	0.2	-	0.2	8.5
Interest expense, net	(2.5)	(1.7)	(5.1)	(3.4)
Foreign exchange gain (loss) on long-term debt	10.7	0.6	6.8	(2.7)
Gain (loss) on derivative financial instruments (note 12)	0.3	8.0	(5.4)	14.9
Foreign exchange gain (loss) on working capital	(2.2)	(0.3)	(1.6)	2.3
Other expense	-	-	(0.2)	(0.1)
	6.5	6.6	(5.3)	19.5
Net income (loss)	1.5	18.2	(20.1)	61.7
Other comprehensive loss				
Adjustment for derivatives (note 15)	(0.1)	(0.2)	(0.1)	(0.3)
Comprehensive income (loss)	\$ 1.4	\$ 18.0	\$ (20.2)	\$ 61.4
Net income (loss) per Partnership unit (in dollars) (note 11)				
Basic and diluted	\$ 0.02	\$ 0.26	\$ (0.28)	\$ 0.87
Weighted average Partnership units outstanding	71,270,025	71,270,025	71,270,025	71,270,025
Partners' Equity				
Balance, beginning of period	\$ 508.5	\$ 602.7	\$ 534.4	\$ 584.9
Net income (loss)	1.5	18.2	(20.1)	61.7
Distributions declared to partners (note 14)	(2.1)	(25.7)	(6.4)	(51.3)
Other comprehensive loss (note 15)	(0.1)	(0.2)	(0.1)	(0.3)
Balance, end of period	\$ 507.8	\$ 595.0	\$ 507.8	\$ 595.0

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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Cash and cash equivalents generated from (used in)				
Operating activities				
Net income (loss)	\$ 1.5	\$ 18.2	\$ (20.1)	\$ 61.7
Items not affecting cash:				
Amortization	12.2	12.0	24.2	23.6
Foreign exchange loss (gain) on long-term debt	(10.7)	(0.6)	(6.8)	2.7
Reduction (increase) in value of outstanding derivative financial instruments (note 12)	(0.1)	(8.0)	2.8	(14.9)
Employee future benefits	0.7	1.9	2.2	4.1
Loss on disposal of fixed assets	-	0.3	-	0.5
Net property damage insurance gain	(0.2)	-	(0.2)	(8.5)
Change in long-term maintenance provision	0.6	3.5	1.5	4.9
Other	-	0.1	-	0.3
Asset retirement obligation expenditures	-	(0.4)	-	(0.9)
Salary pension plan contribution	(0.8)	(0.9)	(1.4)	(0.9)
Long-term maintenance expenditure	(2.6)	(6.6)	(2.6)	(7.0)
Cash flow from (used in) operations before working capital changes	0.6	19.5	(0.4)	65.6
Changes in non-cash working capital (note 13)	22.2	(14.6)	45.0	(9.1)
	22.8	4.9	44.6	56.5
Financing activities				
Distributions paid to partners	(2.1)	(25.7)	(8.5)	(51.3)
Operating loan draw (repayment) (note 8)	(2.5)	5.0	(10.1)	5.0
	(4.6)	(20.7)	(18.6)	(46.3)
Investing activities				
Property, plant and equipment, net (note 13)	(2.2)	(9.1)	(8.2)	(18.4)
Net insurance proceeds	0.3	4.4	0.1	8.0
	(1.9)	(4.7)	(8.1)	(10.4)
Increase in cash and cash equivalents	16.3	(20.5)	17.9	(0.2)
Cash and cash equivalents, beginning of period	2.0	22.9	0.4	2.6
Cash and cash equivalents, end of period	\$ 18.3	\$ 2.4	\$ 18.3	\$ 2.4

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

Supplementary cash flow information (note 13).

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, 2009	As at December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	\$ 18.3	\$ 0.4
Accounts receivable (note 10)		
Trade	113.0	77.0
Insurance	-	7.4
Other	4.0	7.5
Inventories (note 3)	133.9	176.7
Prepaid expenses and other assets	13.2	16.5
Total current assets	282.4	285.5
Property, plant and equipment (note 4)	549.8	570.2
Other long-term assets (note 5)	14.0	13.2
	\$ 846.2	\$ 868.9
LIABILITIES		
Current liabilities		
Operating loan (note 8)	15.1	25.2
Accounts payable and accrued liabilities (note 10)	142.9	121.6
Distributions payable (note 14)	0.7	2.8
Total current liabilities	158.7	149.6
Long-term debt (note 8)	127.9	134.7
Long-term liabilities (note 9)	51.8	50.2
	\$ 338.4	\$ 334.5
PARTNERS' EQUITY – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (note 1)	507.8	534.4
	\$ 846.2	\$ 868.9

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

"Paul Richards"

Paul Richards
Director

Canfor Pulp Limited Partnership

Notes to the Unaudited Interim Consolidated Financial Statements as at June 30, 2009

1. Business Description and Basis of Presentation

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, 2009, 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 64% (2008 Year – 64%) of its fibre supply as well as to provide certain key business and administrative services as described in the Fund's 2008 Annual Report available at www.canforpulp.com or 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 2008 Annual Report available at www.canforpulp.com or www.sedar.com. These unaudited interim consolidated financial statements follow the same accounting policies and methods of computation as used in the 2008 audited consolidated financial statements.

3. Inventories

(millions of dollars, unaudited)	June 30, 2009	December 31, 2008
Pulp	56.1	86.7
Paper	18.7	20.6
Wood chips	14.0	23.3
Processing materials and supplies	45.1	46.1
	133.9	176.7

4. Property, Plant and Equipment

(millions of dollars, unaudited)	June 30, 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	1,321.8	781.8	540.0
Construction in progress	2.9	-	2.9
	1,332.4	782.6	549.8

(millions of dollars, unaudited)	December 31, 2008		
	Cost	Accumulated amortization	Net
Land and improvements	5.4	-	5.4
Asset retirement - Landfill	2.3	0.8	1.5
Buildings, machinery and equipment	1,318.6	757.7	560.9
Construction in progress	2.4	-	2.4
	1,328.7	758.5	570.2

5. Other Long-term Assets

(millions of dollars, unaudited)	June 30, 2009	December 31, 2008
Pension benefit plan	11.6	11.7
Maintenance shutdown costs	1.9	0.9
Other	0.5	0.6
	14.0	13.2

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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Pension plans	1.3	1.0	2.5	1.9
Other employee future benefit plans	0.8	1.5	1.7	3.0
Contributions to forest industry union plans	1.7	1.7	3.3	3.3
	3.8	4.2	7.5	8.2

7. Asset Retirement Obligations

(millions of dollars, unaudited)	June 30, 2009	December 31, 2008
Balance beginning of period	2.8	11.3
Accretion expense	-	0.4
Current expenditures	-	(1.2)
Gain on settlement	-	(0.9)
Change in estimate	-	(6.8)
Balance end of period	2.8	2.8

8. Credit Facilities and Long-term Debt

The Partnership has a \$75.0 million syndicated unsecured revolving bank credit facility (the Revolving Facility), maturing in November 2009, of which \$35.2 million is available with \$24.7 million of the Revolving Facility reserved for standby letters of credit issued to BC Hydro and \$15.1 million drawn to fund working capital requirements as of June 30, 2009. The Revolving Facility bears interest and fees at rates that vary depending on the ratio of net debt to operating earnings before interest, taxes, depreciation and amortization (EBITDA) and which may, at the Partnership's option, be based on lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate. The effective interest rate on the revolving facility for the quarter ended June 30, 2009 was 2.8%.

At June 30, 2009 the Partnership has outstanding long-term debt of \$127.9 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.

Each agreement relative to the Notes and Revolving Facility contains similar financial covenants including four quarter trailing maximum allowable debt to EBITDA leverage ratio of 3.25 and minimum required EBITDA to interest coverage ratio of 2.5 and the Partnership remained in compliance with all covenants at June 30, 2009.

The fair value of long-term debt at June 30, 2009 was \$128.5 million (US\$110.6 million).

9. Long-term Liabilities

(millions of dollars, unaudited)	June 30, 2009	December 31, 2008
Accrued pension obligations	5.5	5.9
Post-employment benefits	42.0	40.8
Derivative financial instruments (note 12)	1.5	0.7
Asset retirement obligations (note 7)	2.8	2.8
	51.8	50.2

10. Related Party Transactions

The Partnership's transactions with related parties are consistent with the transactions described in the December 31, 2008 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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Transactions				
Canfor	27.7	37.6	55.3	77.0
Howe Sound LP – commission	0.6	0.7	1.2	1.4
Howe Sound LP – sale of wood chips	-	0.1	0.1	0.4
Lakeland Mills Ltd. and Winton Global Lumber Ltd. – purchase of wood chips	1.3	2.9	1.8	4.0
<hr/>				
Balance Sheet				
Included in accounts payable and accrued liabilities:				
Canfor			44.0	27.4
Howe Sound LP			28.9	20.4
Lakeland Mills Ltd. and Winton Global Lumber Ltd.			0.2	0.2
Included in trade accounts receivable:				
Product marketed for Canfor			19.7	9.9
Product marketed for Howe Sound LP			27.0	16.9

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

11. Net Income per Partnership Unit

Basic net income per Partnership unit is based on the weighted average number of Limited Partnership units outstanding during the 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.

12. Financial Instruments

Classification of Financial Instruments

The Partnership has classified its cash and cash equivalents as held-for-trading. Accounts receivable are classified as loans and receivables and are measured at amortized cost. Accounts payable and accrued liabilities, distributions payable, operating loan and long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost. Derivative instruments are recorded in the balance sheet at fair value. The Partnership has no derivatives embedded in its financial or non-financial contracts that are not closely related to the host contract.

Financial Risk Management

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

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

I. Credit risk:

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

In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at June 30, 2009 was \$18.3 million. The Partnership does not believe there is any significant credit risk associated with cash on deposit held in major Canadian and international financial institutions.

The Partnership utilizes a combination of credit insurance and self-insurance to manage the risk associated with trade receivables. Approximately 80% of the outstanding trade receivables are covered under credit insurance while the majority of the balance is with large and financially sound customers. In addition, the Partnership requires letters of credit on certain export trade receivables and periodically discounts these letters of credit without recourse. The Partnership recognizes the sale of the letters of credit at the settlement date, and accordingly reduces the related trade account receivable balance. At June 30, 2009, the Partnership had reduced the trade accounts receivable balance by \$33.8 million due to discounting of letters of credit. The Partnership's trade receivable balance at June 30, 2009 was \$113.0 million. The Partnership believes that its approach to managing credit risk associated with the collection of outstanding trade accounts receivable is appropriate in the current credit market.

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

II. Liquidity risk:

Liquidity risk is the risk that the Partnership will be unable to meet its financial obligations as they fall due. The Partnership manages liquidity risk through management of its capital structure in conjunction with cash flow forecasting including anticipated investing and financing activities, and use of the Revolving Facility to meet short-term working capital requirements. The Partnership's Revolving Facility matures in November 2009. The Partnership expects to renew the Revolving Facility for a similar amount, with terms and interest rates based on prevailing market conditions at the time of renewal.

Due to the current global financial crisis, the Partnership is also actively reviewing on an ongoing basis, the level of distributions, capital expenditures and timing of scheduled major maintenance outages and may adjust these amounts periodically to ensure adequate cash is available. In addition, the Partnership is utilizing discounting of letters of credit on outstanding trade receivables to manage liquidity risk. At June 30, 2009, the impact of discounting of letters of credit accelerated cash collection and reduced the trade accounts receivable balance by \$33.8 million. The Partnership believes it will be able to meet all financial obligations as they come due.

At June 30, 2009, the Partnership accounts payable and accrued liabilities totalled \$142.9 million, all of which fall due for payment within one year of the balance sheet date. The Partnership's distributions payable at June 30, 2009 totalled \$0.7 million, which fall due for payment on July 15, 2009.

III. Market risk:

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

a. Interest rate risk:

The Partnership is exposed to interest rate risk through its financial assets and financial obligations bearing variable interest rates and through its operating lease obligations. The Partnership's cash and cash equivalents include term deposits with an original maturity date of 90 days or less.

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

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

b. Currency risk:

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

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

c. Commodity price risk:

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

The Partnership may periodically use derivative instruments to mitigate commodity price risk. For the quarter ended June 30, 2009 the Partnership used derivative instruments to reduce exposure to natural gas prices.

Derivative Instruments

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

For the three months ended June 30, 2009 the Partnership recorded a gain on derivative financial instruments of \$0.3 million (June 30, 2008 – gain of \$8.0 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 foreign exchange hedging contracts.

The Partnership recorded losses of \$2.1 million during the second quarter of 2009 (second quarter 2008 – gain of \$0.9 million) relating to settlement of maturing natural gas contracts as a charge to non-operating income. At June 30, 2009 the Partnership had outstanding commodity swaps hedging future natural gas purchases of 2.6 million gigajoules extending to October, 2011. At June 30, 2009 the loss of \$6.1 million (December 31, 2008 – \$3.2 million) on these outstanding commodity swaps is recorded as a liability in accounts payable and accrued liabilities and in long-term liabilities.

The Partnership recorded a gain of \$2.3 million during the second quarter of 2009 (second quarter 2008 – nil) on settlement of maturing US dollar forward sales contracts as a charge to non-operating income. At June 30, 2009 the Partnership had outstanding US dollar forward sales contracts of \$32.5 million extending to October, 2009. At June 30, 2009 the loss of \$1.1 million (December 31, 2008 – \$1.3 million) on these outstanding US dollar forward sales contracts is recorded as a liability in accounts payable and accrued liabilities.

13. Supplementary Cash Flow Information

(millions of dollars, unaudited)	Three months ended		Six months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Changes in non-cash working capital				
Accounts receivable – trade and other	(14.6)	(2.8)	(32.3)	4.8
Insurance receivable	4.3	8.5	7.3	(5.1)
Inventories	26.9	(5.8)	42.8	(16.3)
Prepaid expenses and other assets	0.4	(8.9)	3.3	(6.1)
Accounts payable and accrued liabilities	5.2	(5.6)	23.9	13.6
	22.2	(14.6)	45.0	(9.1)
Capital expenditures				
Capital expenditures – cash	2.2	9.1	8.2	18.4
Capital expenditures – net accruals	(0.7)	0.5	(4.3)	(5.6)
	1.5	9.6	3.9	12.8
Net interest paid	4.5	3.5	4.8	3.5

Prince George Pulp and Paper Mill Fire and Insurance Settlement

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

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

Final payment received in the second quarter of 2009 was \$8.2 million, of which \$6.8 million related to final settlement of the business interruption insurance claim and \$1.4 million for property damage, of which \$0.3 million has been classified as an investing activity on the cash flow statement, with the balance of \$1.1 million representing demolition costs.

14. Distributions

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

(millions of dollars, except per unit amounts, unaudited)			
Record Date	Payable Date	Amount per Partnership Unit \$	Amount \$
January 30, 2009	February 13, 2009	0.04	2.9
February 27, 2009	March 13, 2009	0.01	0.7
March 31, 2009	April 15, 2009	0.01	0.7
April 30, 2009	May 15, 2009	0.01	0.7
May 29, 2009	June 15, 2009	0.01	0.7
June 30, 2009	July 15, 2009	0.01	0.7
		0.09	6.4

15. Accumulated Other Comprehensive Income

(millions of dollars, unaudited)	Six months ended June 30, 2009	Year ended December 31, 2008
Balance, beginning of period	0.1	0.5
Adjustment for exchange translation	(0.1)	0.2
Adjustment for derivatives recorded in other comprehensive income	-	(0.6)
Balance, end of period	-	0.1

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

(millions of dollars, unaudited)	June 30, 2009
Cumulative comprehensive income	243.2
Cumulative distributions	(322.9)
	(79.7)
Partners' capital – at July 1, 2006	587.5
Partners' equity, end of period	507.8

16. Segmented Information ^(a)

(millions of dollars, unaudited)	Pulp	Paper	Unallocated Costs	Total
Three months ended June 30, 2009				
Sales to external customers ^(b)	173.8	31.2	-	205.0
Sales of pulp to paper segment ^(c)	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
Three months ended June 30, 2008				
Sales to external customers ^(b)	178.2	34.4	-	212.6
Sales of pulp to paper segment ^(c)	20.2	(20.2)	-	-
Operating income (loss)	13.1	1.8	(3.3)	11.6
Amortization	11.0	1.0	-	12.0
Capital expenditures, net	9.4	0.1	0.1	9.6
Six months ended June 30, 2009				
Sales to external customers ^(b)	333.0	58.3	-	391.3
Sales of pulp to paper segment ^(c)	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
Six months ended June 30, 2008				
Sales to external customers ^(b)	354.4	69.6	-	424.0
Sales of pulp to paper segment ^(c)	40.3	(40.3)	-	-
Operating income (loss)	46.1	3.2	(7.1)	42.2
Amortization	21.6	1.9	0.1	23.6
Capital expenditures, net	12.3	0.4	0.1	12.8
Identifiable assets	835.4	71.6	27.7	934.7

- (a) Operations are presented by product lines. Operations are considered to be in one geographic area since all production facilities are in Canada. Substantially all sales are exported outside Canada, with sales to the United States representing 36% (Year 2008 – 43%).
- (b) Sales to the largest customer represented approximately 9% of pulp segment sales (Year 2008 – 22%).
- (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.

17. Contingency

On June 17, 2009 the Canadian federal government announced the Green Transformation Program (GTP). This program proposes to provide \$0.16 per litre credit to qualifying Canadian facilities for black liquor consumption and is capped at \$1 billion of total funding for the industry. It is intended that to the extent of their credit, eligible companies will be reimbursed for capital expenditures within a three-year period that will improve energy efficiency and environmental performance. As details of the program are still to be determined and the funding is intended to be dependent on the amount that will be spent for qualifying capital expenditures, it is impractical at this time to estimate the impact that the GTP will have on the financial position of the Partnership.