



■ **CANFOR PULP INCOME FUND**

ANNUAL REPORT 2006

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In addition to being a global producer of market NBSK, Canfor Pulp Limited Partnership is also a leading producer of fully bleached, high performance Kraft Paper.

■ MESSAGE TO UNITHOLDERS

To our Unitholders:

On June 9, 2006, the shareholders of Canfor Corporation approved the spinout of most of its pulp and paper business and on July 1, 2006, Canfor Pulp Limited Partnership (CPLP) and Canfor Pulp Income Fund (the Fund) began operations. The Fund is an unincorporated, open-ended trust initially holding a 20% stake in CPLP. CPLP in turn owns and operates the pulp and paper assets which include three efficient, low-cost mills in Prince George, British Columbia: the Northwood Pulp mill, the Intercontinental Pulp mill and the Prince George Pulp and Paper mill. Subsequently, on November 30, 2006, Canfor Corporation distributed to its shareholders an additional 29.8% of CPLP as a dividend-in-kind by way of Fund units. As a result, Canfor currently owns 50.2% of CPLP while the Fund owns the remaining 49.8%. The Fund units began trading on the TSX on July 6, 2006 under the symbol CFX.UN.

The Trustees of the Fund, the new Board of Directors and the Management of CPLP embarked on operating this business with the objective of leveraging existing strong customer relationships, experienced and dedicated employees, efficient mill operations and favourable fibre costs in order to maximize distributable cash while assessing future opportunities for growth. Our primary goal is to provide a consistent and reasonable level of monthly cash distributions to our Fund unitholders, in the context of a commodity based business.

In the short time that we have been in existence, we have exceeded the originally expected level of distributions. Our success in 2006 was aided by strong market fundamentals. NBSK pulp prices rose throughout the year and demand remains strong. We achieved record levels of production at our mills and this added to our success. The Fund unitholders shared in the excellent results as we increased monthly distributions and also declared supplemental distributions from September to December. Total cash distributions declared for the six month period from inception were \$1.24 per Fund unit or \$30.4 million.

While there was much to be celebrated in 2006, we are mindful of the fact that we are in a commodity business and must manage our business accordingly. We are continuing our work to reduce costs at our mills and to ensure that programs are in place to mitigate the potential risk of a reduction in chip supply. Given our low cost position we believe that the CPLP operations are some of the most competitive in the Canadian industry today.



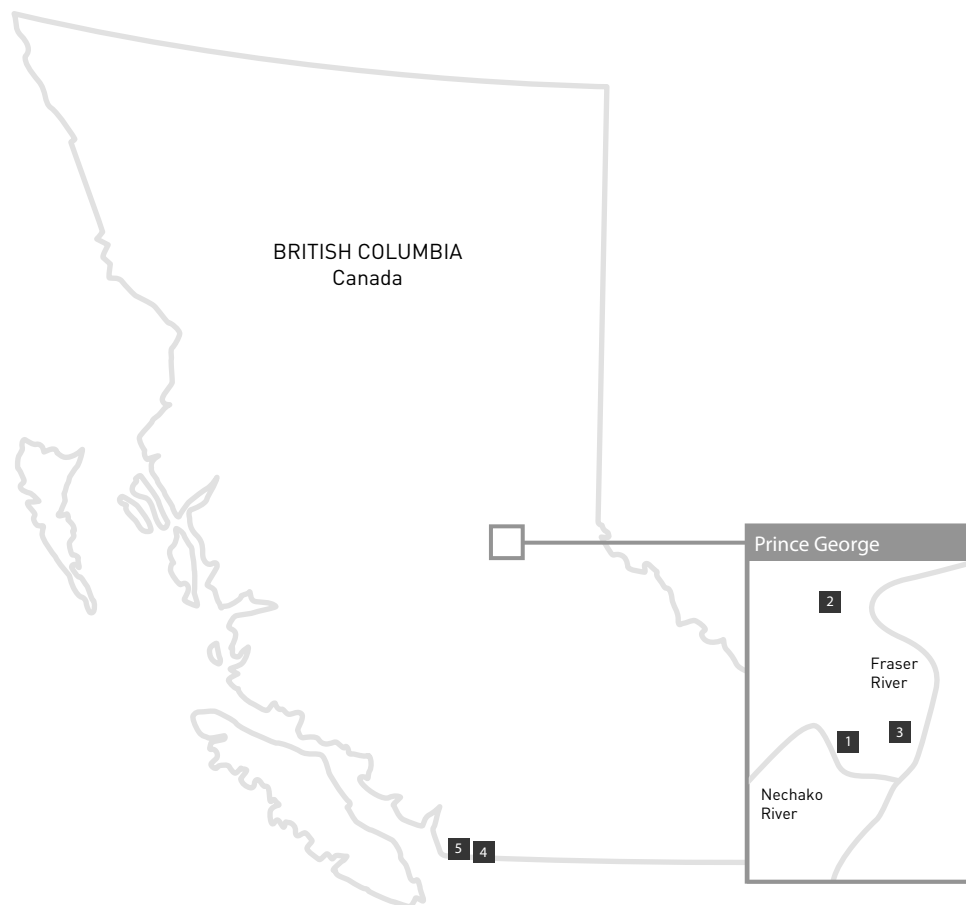
Dr. Charles Jago
Trustee, Canfor Pulp Income Fund
Chairman of the Board, Canfor Pulp Holding Inc.
the general partner of Canfor Pulp Limited Partnership



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

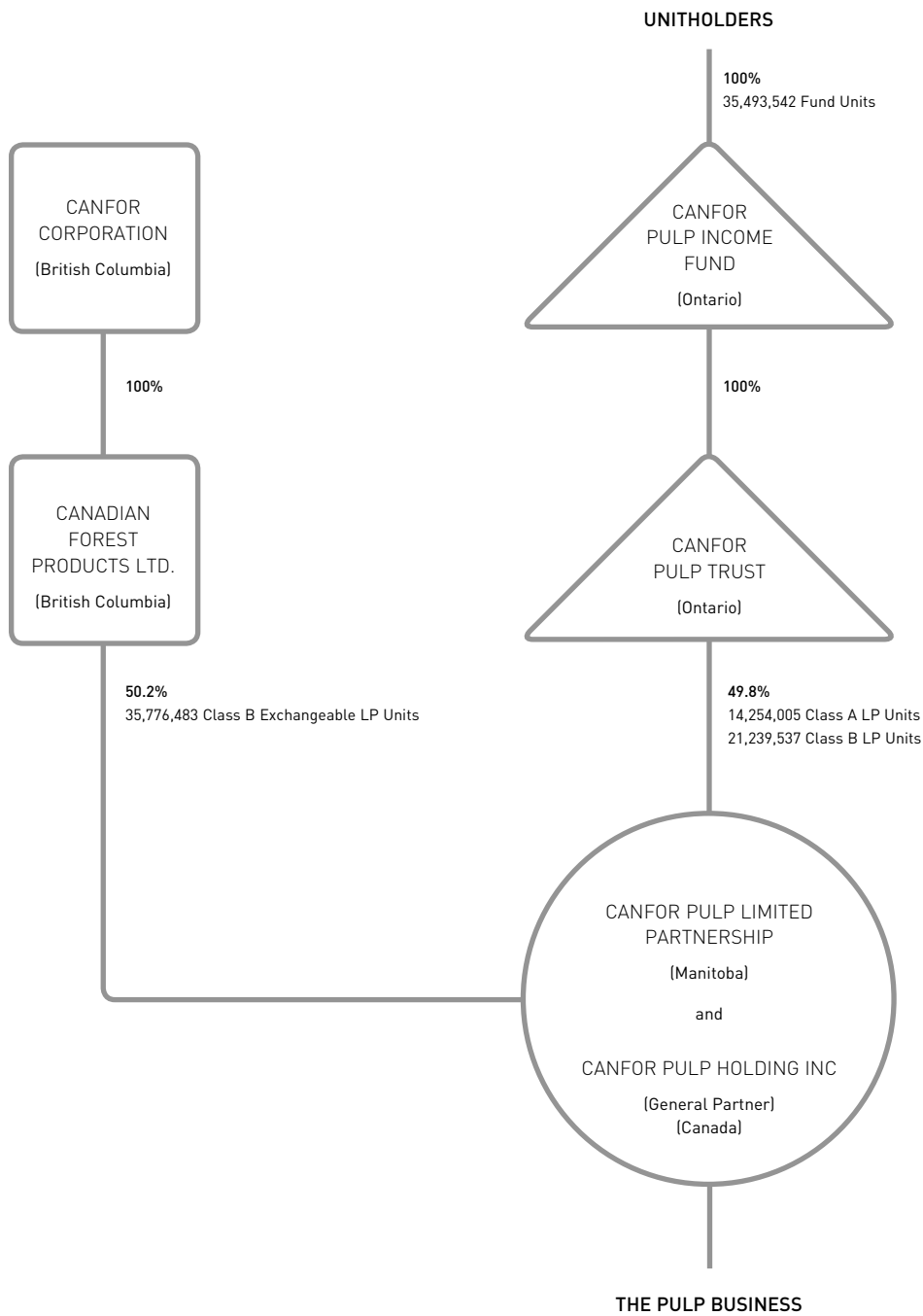
■ OPERATIONS

The Pulp Income Fund is an unincorporated, open-ended trust established under the laws of Ontario, created to indirectly acquire and hold an interest in the Canfor Pulp Limited Partnership (CPLP). Currently the Fund indirectly holds a 49.8% interest in CPLP. CPLP is a leading global supplier of pulp and paper products and operates three mills in Prince George, BC which are among the lowest cost NBSK pulp producers in Canada. CPLP is the second largest North American and fourth largest global producer of market NBSK Pulp, with an annual production of approximately 1 million tonnes and is the leading producer of fully bleached, high performance Kraft Paper.



	Capacity (tonnes)	Key Products
Mills		
1 Intercontinental	310,000	Pulp
2 Northwood	570,000	Pulp
3 Prince George	153,000	Pulp
3 Prince George	135,000	Kraft Paper
Other		
4 Canfor Pulp Limited Partnership / Canfor Pulp Income Fund – Head Office		
5 Canfor Pulp Research and Development Centre		

OWNERSHIP STRUCTURE



■ MANAGEMENT'S DISCUSSION AND ANALYSIS

Canfor Pulp Income Fund (the Fund) earns income from its 49.8% indirect interest in Canfor Pulp Limited Partnership (the Partnership). The Fund accounts for its investment in the Partnership on the equity basis and does not consolidate the operations of the Partnership. In order for the Fund's unitholders to understand the results of operations, the financial statements with accompanying notes are presented for both the Fund and the Partnership. The Partnership did not have an operating business prior to July 1, 2006, and the comparative results prior to this date represent the northern bleached softwood kraft (NBSK) business of Canadian Forest Products Ltd., a subsidiary of Canfor Corporation (collectively Canfor), which the Partnership acquired on July 1, 2006. This Management's Discussion and Analysis (MD&A) provides a review of the significant developments that have impacted the Partnership's performance during 2006 relative to 2005. This MD&A should be read in conjunction with the audited consolidated financial statements and accompanying notes. Factors that could impact future operations are also discussed. These factors may be influenced by 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; exchange rates; changes in law and public policy; and opportunities available to or pursued by the Partnership.

In this document, references are made to EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization or operating income before amortization) and distributable cash. The Partnership considers EBITDA to be an important indicator for identifying trends in the Partnership's performance and of the Partnership's ability to generate funds to meet its debt service, capital expenditure requirements and to make cash distributions to its partners. Distributable cash is a measure of cash flow used by management to determine the level of cash distributions. EBITDA and distributable cash should not be considered as alternatives to net income or cash flow from operations as determined in accordance with Canadian generally accepted accounting principles. As there is no standardized method of calculating these measures, the Partnership's use of these terms may not be directly comparable with similarly titled measures used by other companies or income funds.

Calculations of EBITDA and distributable cash are provided in a schedule at the end of this MD&A.

In this MD&A, for all periods ending prior to July 1, 2006, and for all annual periods, the financial information presented for the Partnership represents its business on a carve out basis (continuity of interests) from Canfor, as if operated as a stand-alone partnership entity for the full periods. The financial information presented includes allocations of Canfor's assets, liabilities and costs. The financial condition, results of operations and cash flows for these periods are not necessarily indicative of the financial condition, results of operations or cash flows that would have been incurred if the business was a separate legal entity.

The information in this report is as at February 16, 2007.

All financial references are in millions of Canadian dollars unless otherwise noted.

CANFOR PULP INCOME FUND

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

On July 1, 2006, the Fund completed the indirect acquisition of 20% of the Prince George, BC based NBSK pulp and paper business of Canfor. Canfor exchanged 14,254,005 Class A Limited Partnership Units for an equal number of Fund units and these units were then distributed by Canfor to its shareholders. As a result of these transactions, on July 1, 2006, Canfor shareholders owned all of the issued and outstanding Fund units, and the Fund held all issued and outstanding Class A Limited Partnership Units representing a 20% indirect interest in the Partnership. Canfor, through its ownership of Class B Exchangeable Limited Partnership Units, which are indirectly exchangeable for Fund units, owned the remaining 80% interest in the Partnership.

On November 30, 2006, Canfor exchanged 21,239,537 Class B Exchangeable Limited Partnership Units of the Partnership for the same number of newly issued Fund units and immediately distributed these Fund units to its shareholders as an in-kind taxable dividend of 1.49 units for every 10 Canfor shares held. Following completion of this exchange, there are a total of 35,493,542 Fund units issued and outstanding, and the Fund indirectly holds a total of 35,493,542 units of the Partnership, representing 49.8% of the Partnership and Canfor holds 35,776,483 Class B Exchangeable Limited Partnership Units, representing 50.2% of the Partnership.

Each unitholder participates pro-rata in any distributions from the Fund. Income tax obligations related to the distributions of the Fund are the obligations of the unitholders and the Fund is only taxable on any amount not allocated to the unitholders.

EQUITY INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

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

(thousands of dollars, unaudited)

Initial investment in the Partnership on July 1, 2006 – 14,254,005 Fund units	\$ 116,560
Issuance of Fund units for exchangeable Partnership units (November 30, 2006) – 21,239,537 Fund units	182,792
Cumulative equity in income of the Partnership	20,558
Cumulative distributions received and receivable	(30,419)
Equity investment in the Partnership as at December 31, 2006	\$ 289,491

The Fund's investment in the Partnership units is recorded using the equity method. The Fund's initial investment in the Partnership on July 1, 2006 represented the Fund's 20% ownership in the transfer of the Pulp and Paper business from Canfor to the Partnership. On November 30, 2006 Canfor exchanged 21,239,537 Class B Exchangeable Limited Partnership Units for the same number of newly issued Fund units for a total value of \$182.8 million (\$8.61 per unit), representing the Fund's pro-rata share of the carrying value of the Partnership units received on the date of the exchange.

OPERATING RESULTS AND LIQUIDITY

For the six-month period ended December 31, 2006, the Fund had earnings of \$20.6 million, or \$1.15 per unit, representing its share of earnings of the Partnership for the period. Distributions declared by the Partnership and accruing to the Fund were \$30.6 million of which \$12.9 million was receivable at year-end. Cash distributions received from the Partnership are the only source of liquidity for the Fund. The Fund's requirements of administrative services are minimal and are funded through an expense distribution from the Partnership.

FUND DISTRIBUTIONS

The Fund is entirely dependent on distributions from the Partnership to make its own distributions and declares distributions on a monthly basis with the record date on the last day of each month and payable within the 15 days following. Distributions from the Fund's investment in the units of the Partnership and distributions payable by the Fund to its unitholders are recorded when declared. During 2006, the Fund declared distributions of \$1.24 per unit or a total of \$30.4 million.

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

FUND UNITS

At December 31, 2006, the Fund had 35,493,542 units outstanding compared to 14,254,005 units outstanding at September 30, 2006.

RISKS AND UNCERTAINTIES RELATED TO THE STRUCTURE OF THE FUND

CONTROL OF THE PARTNERSHIP

Pursuant to a shareholders' agreement, Canfor is entitled to appoint four of the seven directors to the board of the General Partner for so long as it owns not less than 30% of the outstanding Limited Partnership units. For so long as Canfor holds not less than a 20% indirect economic interest in the Partnership, Canfor's consent will be required in order to approve certain significant transactions of the Partnership. In addition, under the Exchange Agreement, the Fund and the Trust will agree not to take certain actions without the prior approval of Canfor. As a result of these rights, Canfor will exercise significant influence or control over transactions submitted to the board of the General Partner and to the Fund trustees. Canfor may have sufficient voting power to prevent a change of control of the Partnership. The Fund has an indirect minority interest in the Partnership and minority representation on the board of the General Partner and therefore has limited influence over transactions of the Partnership.

The interests of Canfor may conflict with those of Fund unitholders.

DEPENDENCE ON THE PARTNERSHIP

The Fund is entirely dependent on the operations and assets of the Partnership. Cash distributions to unitholders will be dependent on, among other things, the ability of the Partnership making cash distributions. The ability of the Fund and its subsidiaries to make cash distributions or other payments or advances is subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities.

CASH DISTRIBUTIONS ARE NOT GUARANTEED AND WILL FLUCTUATE WITH THE BUSINESS PERFORMANCE

Although the Fund intends to distribute the cash distributions received through the Trust from the Partnership, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Fund units, there can be no assurance regarding the amount of income to be generated by the Partnership's business or ultimately distributed to the Fund. The ability of the Fund to make cash distributions, and the actual amount distributed, will be entirely dependent on the operations and assets of the Partnership, and will be subject to various factors including its financial performance, its obligations under applicable credit facilities, fluctuations in its working capital, the sustainability of its margin and its capital expenditure requirements. The market value of the Fund units may deteriorate if the Fund is unable to meet its distribution targets in the future.

TAXATION OF PUBLICLY TRADED INCOME TRUSTS

On October 31, 2006, the Canadian Federal Government announced proposed plans to apply a tax on distributions from publicly traded income trusts, such as the Fund. For existing income trusts the government is proposing a four-year transition period until their 2011 taxation year before the tax would be applicable. The impact to the Fund is unknown at this time and may be significant. In addition, the proposed plans include a limitation on growth of entities such as the Fund during the transition period, which may limit the amount of new units that can be issued by the Fund, which in turn can limit investment opportunities for the Fund.

RELATED PARTY TRANSACTIONS

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf by the Partnership pursuant to a support agreement. For the six months ended December 31, 2006, the Fund had incurred operating expenses with third parties of \$142,000. During the fourth quarter, the Partnership declared an expense distribution to cover the operating expenses of the Fund as provided for in the Partnership agreement. The expense distribution is accounted for by the Fund as a recovery of operating expenses and presented on a net basis in the consolidated statement of income and accumulated distributions and earnings.

SUBSEQUENT EVENTS

On January 24, 2007 the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on February 15, 2007 to unitholders of record on January 31, 2007. On February 16, 2007, the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on March 15, 2007 to unitholders of record on February 28, 2007.

CANFOR PULP LIMITED PARTNERSHIP

STRUCTURE

The Partnership was formed on April 21, 2006, under the laws of Manitoba to acquire and carry on the NBSK pulp and paper business of Canfor. The business consists of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, BC and a marketing group based in Vancouver, BC (the Pulp Business).

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Exchangeable Limited Partnership Units (the Spinout). Canfor then exchanged its Class A Limited Partnership Units for an equal number of units of the Fund. Upon the completion of the Spinout, Canfor shareholders were entitled to receive one New Common Share of Canfor and 0.1 of a unit of the Fund (Fund unit), with the distribution of the Fund units being structured as a return of capital on the Canfor shares.

On November 30, 2006, Canfor transferred 21,239,537 Class B Limited Partnership Units of the Partnership to the Fund in exchange for the same number of Fund units. Following completion of this exchange, the Fund indirectly holds a total of 14,254,005 Class A Limited Partnership Units and 21,239,537 Class B Limited Partnership Units, representing 49.8% of the Partnership and Canfor owns the remaining 50.2%. The Partnership is managed, on behalf of the limited partners, by Canfor Pulp Holding Inc., the General Partner.

A simplified schematic of the ownership structure appears on page 5.

BUSINESS

The Partnership is a leading global supplier of pulp and paper products with operations based in the central interior of British Columbia. The Partnership's strategy is to maximize cash flows and enhance the value of its assets by: (i) preserving its low-cost operating position, (ii) maintaining the premium quality of its products and (iii) opportunistically acquiring high quality assets.

The Partnership owns and operates three mills with annual capacity to produce over one million tonnes of northern softwood market kraft pulp, 90% of which is bleached to become NBSK pulp, for sale to the market and approximately 135,000 tonnes of kraft paper. The mills are among the lowest cost producers in Canada with a first quartile ranking based on average cost of production of NBSK pulp in the most recent PricewaterhouseCoopers LLP Market Pulp study (2005) of competitive costs of Canadian pulp mills.

HIGHLIGHTS

- The Pulp Business of Canfor was spun out into the Canfor Pulp Limited Partnership on July 1, 2006
- November 30, 2006 Canfor divvied out an additional 30% of the Partnership to shareholders of record on November 15, 2006
- Annual production record of 1,015,400 tonnes of market NBSK set in 2006
- Total EBITDA of the pulp and paper business for 2006 of \$184.1 million
- Total distributions in the first six months of existence for the Partnership of \$88.5 million to its limited partners

SELECTED ANNUAL INFORMATION

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

	2006	2005	2004
Sales volume - major products			
Pulp - thousands of metric tonnes	1,001.5	982.1	974.4
Paper - thousands of metric tonnes	124.6	127.2	139.8
Sales by segment			
Pulp	\$ 720.9	\$ 653.8	\$ 704.0
Paper	113.5	117.4	126.3
Total sales	\$ 834.4	\$ 771.2	\$ 830.3
Operating income (loss)			
Pulp	\$ 146.3	\$ 26.7	\$ 58.8
Paper	3.2	3.6	(5.5)
Unallocated costs	(14.4)	(13.6)	(18.2)
Total operating income	135.1	16.7	35.1
Non-operating income (expense)			
Business acquisition costs	(5.9)	-	-
Interest expense, net	(3.8)	-	-
Foreign exchange loss on long-term debt	(2.5)	-	-
Other income (expense)	0.1	(0.2)	0.1
Total non-operating income (expense)	(12.1)	(0.2)	0.1
Net income	\$ 123.0	\$ 16.5	\$ 35.2
Total assets	\$ 893.4	\$ 878.4	\$ 894.2
Total long-term debt	\$ 128.2	\$ -	\$ -
Net income per Partnership unit			
Basic and diluted	\$ 1.73	\$ 0.23	\$ 0.49
Cash distributions declared (paid and payable)	\$ 88.5	\$ -	\$ -
Average Canadian/U.S. exchange rate¹	\$ 0.882	\$ 0.825	\$ 0.768

(1) Source - Bank of Canada (average noon rate for the period)

2006 COMPARED TO 2005

The 2006 year was highlighted with the successful spinout of the Pulp Business into the Partnership, a record year for operational performance, strong markets and a good cost structure. Net income for 2006 increased by \$106.5 million and EBITDA by \$120.2 million over 2005. This significant improvement was due to increased sales prices and significantly lower fibre costs. NBSK pulp prices in U.S. dollars increased, but combined with the effect of the strengthening Canadian currency, the net realized prices in Canadian dollar terms increased by only 4% over 2005. Increased sales and production volumes and lower fibre and conversion costs all contributed to the improved results.

SELECTED QUARTERLY FINANCIAL INFORMATION

(unaudited)	Q4 2006	Q3 2006	Q2 2006	Q1 2006	Q4 2005	Q3 2005	Q2 2005	Q1 2005
Sales and income (millions of dollars)								
Sales	\$ 229.0	\$ 214.3	\$ 194.9	\$ 196.2	\$ 195.9	\$ 193.1	\$ 198.9	\$ 183.3
Operating income (loss)	\$ 49.3	\$ 49.7	\$ 15.7	\$ 20.4	\$ 16.7	\$ (3.1)	\$ (5.2)	\$ 8.3
EBITDA	\$ 61.9	\$ 62.5	\$ 26.8	\$ 32.9	\$ 29.0	\$ 9.1	\$ 5.9	\$ 19.9
Net income (loss)	\$ 44.8	\$ 41.9	\$ 15.9	\$ 20.4	\$ 16.6	\$ (3.1)	\$ (5.2)	\$ 8.2
Per Partnership unit (dollars) ²								
Net income (loss), basic and diluted	\$ 0.63	\$ 0.59	\$ 0.22	\$ 0.29	\$ 0.23	\$ (0.04)	\$ (0.07)	\$ 0.12
Statistics								
Pulp shipments (000 mt)	249.8	251.4	244.6	255.7	260.7	257.9	246.8	216.7
Paper shipments (000 mt)	32.8	29.5	31.3	31.0	30.6	31.1	33.0	32.5
Average exchange rate (Cdn\$/US\$)	\$ 0.878	\$ 0.892	\$ 0.891	\$ 0.866	\$ 0.852	\$ 0.832	\$ 0.804	\$ 0.815
Average NBSK pulp list price delivered to Northern Europe (US\$)	\$ 730	\$ 711	\$ 670	\$ 622	\$ 600	\$ 588	\$ 613	\$ 642

[2] Based on Partnership units outstanding at December 31, 2006 (71,270,025) for all periods

Sales are primarily influenced by changes in market pulp prices and fluctuations in Canadian/U.S. dollar exchange rates. Operating income, net income and EBITDA are primarily impacted by sales and price fluctuations in raw material inputs, energy prices and maintenance costs.

FOURTH QUARTER 2006 RESULTS

The Partnership had net sales of \$229.0 million, net income of \$44.8 million, or \$0.63 per unit, and EBITDA of \$61.9 million, or \$0.87 per unit, for the quarter ended December 31, 2006. These results, which are similar to the third quarter, reflect improvements in NBSK pulp pricing in all markets, the benefits of a weaker Canadian dollar and improved results from the kraft paper business, all of which were offset by higher costs. The increased costs in the fourth quarter, when compared to the prior quarter, were primarily related to fibre costs, and in addition, seasonally normal increase in the use of energy, increased costs for maintenance due to timing of several routine projects and higher administration costs. When compared to the fourth quarter of 2005, costs were lower with the exception of fibre.

Fibre costs increased during the quarter, driven by a rise in pulp mill sales returns, and in addition, market conditions brought about by reduction of sawmill residual chip volumes due to the slowing lumber markets. A small component of the cost increase was also due to the production of roundwood chips. This program was initiated in the fourth quarter of 2006 to replace sawmill residual reductions and will continue for the next few months. The Partnership may continue the roundwood chipping program in the second half of the year depending on the sawmill operating environment.

The Partnership's mills ran well with no significant maintenance downtime in the third or fourth quarters, except for the cogeneration system where power production was curtailed for the installation of modifications to the ash handling system.

- The Pulp segment earned operating income of \$50.6 million in the fourth quarter of 2006, compared with operating income of \$18.5 million in the same quarter in 2005. When compared to the prior year the benefit of an 18% increase in Canadian net realized price was partially reduced by lower sales volumes and higher fibre costs.
- The Paper segment earned operating income of \$2.6 million in the fourth quarter of 2006, compared with operating income of \$1.7 million in the same quarter in 2005. Net realized price in U.S. dollars increased by 11% over the same period a year ago. Price increases and higher sales volumes were partially offset by higher costs for slush pulp, which is transferred at market price.
- Unallocated costs, comprised principally of general and administrative expenses, totalled \$3.9 million in the fourth quarter compared to \$3.5 million in the same period last year. Unallocated costs were higher as a result of higher administrative costs including audit fees, salaried employees incentive plan and legal fees. The administrative costs in prior year comparative periods primarily represent allocations of Canfor's corporate administration, legal services, human resources, treasury services and incentive plan amounts. These were based on estimates of the pulp business' share of Canfor's corporate costs. A refund of provincial sales tax of \$1.1 million reduced unallocated costs in 2005.

More detailed analysis of the fourth quarter 2006 results is found in the Fourth Quarter 2006 press release dated February 16, 2007.

OPERATING RESULTS BY BUSINESS SEGMENT

PULP

(millions of dollars unless otherwise noted, unaudited)

	2006	2005
Sales	\$ 720.9	\$ 653.8
EBITDA	\$ 191.3	\$ 70.1
EBITDA margin	27%	11%
Operating income	\$ 146.3	\$ 26.7
Average pulp list price – US\$ ³	\$ 683	\$ 611
Average pulp list price – Cdn\$	\$ 774	\$ 741
Production – pulp (000 mt)	1,015.4	983.2
Shipments – Partnership-produced pulp (000 mt)	1,001.5	982.1
Marketed on behalf of HSLP & Canfor (000 mt)	570.6	579.9

[3] Per tonne, delivered to Northern Europe

Operating income of the pulp segment increased by \$119.6 million when compared to 2005 results. Strong performance at all mills, including an annual record for total tonnes produced, combined with improved markets and lower costs were partially offset by the strengthening Canadian dollar. Net sales increased by \$67.1 million over 2005 as a result of a 12% increase in the average pulp list price offset by the strengthening Canadian dollar which averaged Cdn\$/US\$0.882 in 2006 compared to \$0.825 in 2005. Also positively impacting net sales was the shift of a higher volume of sales to North American markets, primarily at the expense of Europe, which resulted in higher revenues as the North American market list prices averaged US\$34 per tonne higher than those in Europe. Overall costs were lower in 2006 primarily due to the beneficial impact of lower chip prices, lower overall maintenance expense and lower energy costs due to full year of operation of the cogeneration project at Prince George Pulp mill.

OPERATIONS

An annual production record for total tonnes highlighted 2006, surpassing the previous record by 20,000 tonnes. NBSK production during the year was higher by 32,200 tonnes over 2005. The increase was due to improved performance and reliability at all facilities and the Prince George Pulp mill ramped up to full rate from its curtailed production in 2005 due to precipitator installation. Total maintenance downtime for all three mills was 39 days in 2006, the same as 2005. The Partnership has moved to an 18-month cycle for its major maintenance outages and staggers these between the three pulp mills.

The cogeneration facility at the Prince George Pulp mill operated for the full year in 2006 averaging 919-megawatt hours per day compared to 788 in 2005. The cogeneration project was commissioned in 2005 and commenced electrical power generation in May 2005. A 4 day outage, taken in December 2006, for the installation of improvements to the ash handling system, contributed to reduced power generation during the fourth quarter of 2006. Additional modifications to the cogeneration system are expected during 2007 to further improve its performance.

MARKETS

The Partnership experienced strong and improved demand during 2006 compared to 2005. This was partly driven by increased consumption from Europe and Asia but mostly due to the large reduction in Canadian NBSK production capacity (approximately 1 million tonnes or 16% of Canadian capacity was shut in 2006). The capacity reduction was primarily the result of mill closures in Eastern Canada due to high fibre and energy costs and the strengthening Canadian dollar.

List prices increased in all markets during 2006, with the benchmark price for NBSK pulp delivered into Northern Europe averaging US\$683 per tonne in 2006 compared to US\$611 in 2005. Inventory levels for NBSK pulp declined to 24 days of supply, with 30 days of supply generally considered to be a balanced market.

OUTLOOK – PULP MARKETS

In January 2007, list price increases were announced in all markets. For Northern Europe a US\$30 to US\$40 increase was announced, which will take prices to US\$760 to US\$770 per tonne. In the United States, a US\$20 increase will bring prices to US\$790. The Asian markets also saw a US\$20 list price increase announcements, which would take prices to US\$730 to US\$760 depending on the country of delivery.

Looking ahead into 2007, we believe that demand and pricing will hold up well through the first half of the year. While global economies are projected to slow somewhat, the year is beginning with very low global inventories and the NBSK market is expected to continue to be in short supply. Some moderation in prices in the second half of 2007 may occur.

PAPER

(millions of dollars unless otherwise noted, unaudited)

	2006	2005
Sales	\$ 113.5	\$ 117.4
EBITDA	\$ 7.0	\$ 7.4
EBITDA margin	6%	6%
Operating income	\$ 3.2	\$ 3.6
<hr/>		
Production – paper (000 mt)	129.1	127.4
Shipments – paper (000 mt)	124.6	127.2

Operating income of the paper segment decreased by \$0.4 million from 2005. Net realized price in U.S. dollars increased by 6% over the prior year but this was more than offset by the impacts of the stronger Canadian dollar and slightly lower sales volume in 2006. Higher costs for slush pulp, which is transferred to the paper mill at market price, were offset by overall lower conversion costs and improved productivity.

OPERATIONS

The paper machine had a very strong year producing 1,700 tonnes above 2005. A key performance indicator for the paper machine is tonnes produced to customer orders which set an annual best in 2006 averaging 352 tonnes per day compared to 332 in 2005 and the previous best of 349 in 2004. Operations continue to focus on higher margin bleached paper production, which averaged 70% in 2006 compared to 68% in 2005.

MARKETS

Demand remained steady in 2006 with sales matching production. We continue to grow our shipments into the North American market, specifically in the higher margin bleached products. Tight supply was the main driver of the strong kraft paper market throughout 2006.

OUTLOOK – KRAFT PAPER MARKETS

Kraft paper markets are expected to remain strong throughout 2007, as the demand supply balance is still tight on the supply side. A further price increase for bleached kraft paper is expected in the second quarter of 2007.

NON-SEGMENTED ITEMS

(millions of dollars, unaudited)

	2006	2005
Unallocated costs	\$ 14.4	\$ 13.6
Business acquisition costs	5.9	-
Net interest expense	3.8	-
Foreign exchange loss on long term debt	2.5	-
	<u>\$ 26.6</u>	<u>\$ 13.6</u>

UNALLOCATED COSTS

Unallocated costs, comprised principally of general and administrative expenses, totalled \$14.4 million in 2006 compared to \$13.6 million in the prior year. Unallocated costs were higher as a result of additional administrative costs including audit fees, salaries and legal fees. The administrative costs in prior year comparative periods primarily represent allocations of Canfor's corporate administration, legal services, human resources, treasury services and incentive plan amounts. These were based on estimates of the Pulp Business' share of Canfor's corporate costs. A refund of provincial sales tax of \$1.1 million reduced unallocated costs in 2005.

BUSINESS ACQUISITION COSTS

The Partnership incurred costs related to its initial organization and the acquisition of the Pulp Business from Canfor, fully described in note 1 to the financial statements of the Partnership, principally comprised of legal, accounting, audit and consulting fees.

INTEREST EXPENSE

Net interest expense of \$3.8 million represents July to November interest at prime plus 0.5% paid to Canfor for borrowing under the \$125 million promissory note and interest at a rate of 6.41% paid to the holders of the US\$110 million (Cdn\$125.7 million) notes issued on November 30, 2006. Proceeds of the issuance of the US\$110 million notes were used to retire the \$125 million Canfor promissory note. The interest expense is net of interest earned on cash and cash equivalent investments. No interest expense is shown for periods prior to July 1, 2006, since the Pulp Business was an integral part of Canfor and interest was not allocated to it.

SUMMARY OF FINANCIAL POSITION

The following table summarizes the Partnership's financial position as at December 31 of each year:

(millions of dollars, except for ratios, unaudited)	2006	2005
Ratio of current assets to current liabilities	1.92	2.02
Ratio of net debt to partners' equity ⁽⁴⁾	0.17	-
Increase (decrease) in cash and cash equivalents – comprised of cash flow from (used in):	\$ 27.8	\$ (0.8)
Operating activities	168.2	70.0
Financing activities	(58.1)	(27.8)
Investing activities	(82.3)	(43.0)

(4) comprised of long-term debt net of cash and cash equivalents

CHANGES IN FINANCIAL POSITION

Operating activities generated \$168.2 million in cash in 2006, which was a \$98.2 million improvement over the same period last year, principally due to significantly higher NBSK pulp prices, higher sales volumes and lower fibre costs.

Cash flows from financing activities represent net cash transactions with Canfor prior to the spinout. Prior to the spinout the Pulp Business operating transactions such as sales of products, and purchases of products and services, were settled in the divisional equity account as they occurred. The excess cash flows of the Pulp Business were transferred to the central cash management system of Canfor.

The \$82.3 million of cash used in investing activities in the year represents \$62.7 million of distributions paid to Canfor and the Fund, with the balance relating to net capital expenditures.

TRANSACTIONS WITH RELATED PARTIES

The Partnership's transactions with related parties are based on agreed upon amounts, unless otherwise noted below.

The Partnership purchased wood chips and hog fuel from Canfor sawmills in the amount of \$83.3 million in 2006 (2005 – \$106.2 million). The Partnership also purchased wood chips from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor owns a one-third interest. Purchases from these entities in 2006 were \$8.6 million (2005 – \$11.1 million).

Effective July 1, 2006, the Partnership entered into a services agreement under which Canfor provides certain business and administrative services to the Partnership. Total value of the services provided in 2006 was \$8.5 million (2005 – \$11.6 million). The corporate costs in comparative periods prior to the acquisition were based on estimates of the Pulp Business' share of Canfor's corporate costs (see note 1 to the Partnership's financial statements).

Effective July 1, 2006, the Partnership entered into an incidental services agreement with Canfor, under which the Partnership provides certain business and administrative services to Canfor. Total value of the services provided in 2006 was \$1.5 million (2005 – \$1.5 million).

The Partnership markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill for which it earned commissions totaling \$2.3 million in 2006 (2005 – \$2.8 million). The Partnership also purchased pulp from the Canfor Taylor Pulp Mill for resale totaling \$10.1 million in 2006 (2005 – \$8.0 million). In respect of the products marketed and services provided for the Canfor Taylor Pulp Mill, the Partnership held balances of \$6.3 million in accounts receivable-trade and \$6.6 million in accounts payable to Canfor at December 31, 2006 (2005 – \$8.8 million accounts receivable-trade and \$9.8 million in accounts payable to Canfor).

The Partnership markets the NBSK pulp produced by Howe Sound Pulp and Paper Limited Partnership (HSLP) for which it earned commissions totaling \$4.7 million in 2006 (2005 – \$6.0 million). In respect of the products marketed and service provided for HSLP, the Partnership held balances of \$31.9 million in accounts receivable-trade and \$23.1 million in accounts payable to HSLP at December 31, 2006 (2005 – \$32.3 million in accounts receivable-trade and \$35.6 million in accounts payable to HSLP).

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14,254 million Class A Limited Partnership Units and 57,016 million Class B Exchangeable Limited Partnership Units. The Partnership paid this debt in full on November 30, 2006. Total interest paid or payable to Canfor was \$3.7 million in 2006.

At December 31, 2006, a total of \$14.3 million was outstanding as accounts payable to Canfor in respect of purchases of wood chips, hog fuel, services and amounts paid on behalf of the Partnership. At December 31, 2006, a total of \$0.8 million was payable to Lakeland Mills Ltd. and Winton Global Lumber Ltd. for wood chips (2005 - \$0.7 million).

During 2006, the Partnership declared distributions totaling \$88.5 million to its limited partners. Distributions to Canfor were \$57.9 million, of which \$45.0 million was paid, with the balance of \$12.9 million payable on December 31, 2006. Distributions to the Fund were \$30.6 million, of which \$17.7 million was paid, with the balance of \$12.9 million payable on December 31, 2006.

LIQUIDITY AND FINANCIAL REQUIREMENTS

On November 30, 2006, the Partnership completed a debt financing by private placement of US\$110 million (Cdn\$125.7 million) of unsecured notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013. The proceeds from the issuance of the Notes were used to repay the \$125 million Canfor promissory note. The Partnership also entered into a 3-year \$75 million syndicated unsecured revolving bank credit facility (the Revolving Facility) with \$30.6 million of the Revolving Facility reserved for a standby letter of credit for BC Hydro. 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 option of the Partnership, be based on lenders' Canadian prime rate, bankers acceptances, U.S. base rate or U.S. LIBOR rate.

Each agreement with respect to the Notes and Revolving Facility contains the same covenants with respect to certain financial ratios and at December 31, 2006 the Partnership was in compliance with all covenants.

OUTSTANDING UNITS

At February 16, 2007, there were a total of 71,270,025 Limited Partnership Units outstanding, consisting of 14,254,005 Class A Limited Partnership Units and 21,239,537 Class B Limited Partnership Units owned by the Fund through the Trust and 35,776,483 Class B Exchangeable Limited Partnership Units owned indirectly by Canfor.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements. Management regularly reviews these estimates and assumptions based on currently available information. While it is reasonably possible that circumstances may arise which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect the Partnership's financial condition.

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 costs and related obligations of these plans are accrued in accordance with the recommendation of the Canadian Institute of Chartered Accountants (CICA).

Independent actuarial firms are used to perform actuarial valuations of the fair value of benefit obligations. The application of these recommendations requires judgments regarding certain assumptions that affect the benefit provisions and related expenses, including the discount rate used to calculate the present value of the obligation and the assumed health care cost trend rates. Management evaluates these assumptions annually based on its own experience and the recommendations of its actuarial firms. Changes in these assumptions result in actuarial gains or losses which are amortized over the average remaining service period of the group covered by the plans to the extent that it is in excess of 10% of the accrued benefit obligation.

CHANGE IN ACCOUNTING POLICY – MAJOR MAINTENANCE COSTS

The Partnership adopted the deferral method of accounting for major maintenance costs. Under this method an asset is recorded when expenditures for maintenance costs related to major maintenance are incurred. This asset is then amortized over the period to which the maintenance relates. The amounts in prior periods are not considered material for restatement.

RECENT ACCOUNTING PRONOUNCEMENTS

The CICA has issued three new pronouncements (Handbook Sections) which will apply to the Partnership as of January 1, 2007: Section 3855 "Financial Instruments", Section 3865 "Hedges" and Section 1530 "Comprehensive Income". Section 3855 prescribes when a financial instrument should be recognized on the balance sheet and at what amount. It also specifies how to present financial instrument gains and losses. Section 3865, which is optional, provides alternative treatments to Section 3855 for when qualifying transactions are designated as hedges for accounting purposes. Section 1530 introduces new requirements for situations when certain gains and losses must be temporarily presented outside of net income in a new Statement of Comprehensive Income.

The Partnership has not made a final decision with respect to the adoption of some of the presentation alternatives available under the new pronouncements, except for the one noted below. The adoption of these new pronouncements is not expected to have a material effect on the Partnership's financial position or results of operation.

At December 31, 2006, the Partnership had deferred financing costs of \$1.6 million related to the credit facilities and long-term debt entered into on November 30, 2006. In accordance with the transitional provisions, this balance will be transferred to Opening Partners' Equity at January 1, 2007.

CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

In addition to the obligations noted in "Financial requirements and Liquidity", the Partnership has committed to the following operating leases for property, plant and equipment. As at December 31, 2006, the future minimum lease payments under these operating leases were as follows:

(millions of dollars, unaudited)

2007	\$	3.0
2008		1.5
2009		0.7
Thereafter		0.5
Total minimum lease payments	\$	5.7

In 2003, Canfor entered into an agreement with BC Hydro to build an electrical cogeneration facility at the Prince George Pulp and Paper Mill. Under the agreement, BC Hydro contributed \$45.8 million of the project costs, with Canfor contributing the balance. The agreement was assigned to the Partnership effective July 1, 2006, with incentive payments totaling \$11.4 million outstanding. The final incentive payment of \$11.4 million was received August 9, 2006, and transferred to Canfor. The total incentive payments of \$45.8 million were accounted for as a credit to property, plant and equipment of the Partnership. The project was completed in the second quarter of 2005 at a net cost to the Pulp Business of \$69.6 million. The agreement entails a 15 year commitment with BC Hydro for power displacement at the cogeneration facility, whereby a proportionate repayment is required should the facility not generate the minimum of 390 gigawatt hours of electricity per year. Under the agreement, the Partnership is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated.

As of December 31, 2006, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount \$30.6 million was issued to BC Hydro.

DERIVATIVE FINANCIAL INSTRUMENTS

The Partnership utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange and commodity price risk. For example, from time to time, it purchases foreign exchange forward contracts to hedge anticipated sales to customers in the United States and the related accounts receivable and also enters into swap transactions to reduce its exposure to fluctuating prices for the purchase of natural gas and the sale of NBSK pulp. The Partnership policy is not to utilize derivative financial instruments for trading or speculative purposes.

SUBSEQUENT EVENTS

On January 24, 2007 the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on February 15, 2007 to unitholders of record on January 31, 2007. On February 16, 2007, the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on March 15, 2007, to unitholders of record on February 28, 2007.

RISKS AND UNCERTAINTIES RELATED TO THE BUSINESS AND INDUSTRY

CYCLICALITY OF PRODUCT PRICES

The Partnership's financial performance is dependent upon the selling prices of its pulp and paper products, which have fluctuated significantly in the past. The markets for these products are highly cyclical and characterized by (i) periods of excess product supply due to industry capacity additions, increased production and other factors; and (ii) periods of insufficient demand due to weak general economic conditions. The economic climate of each region where the Partnership's products are sold has a significant impact upon the demand, and therefore, the prices for pulp and paper. In particular, the list price of pulp has historically been unpredictable.

CURRENCY EXCHANGE RISK

The Partnership's operating results are sensitive to fluctuations in the exchange rate of the Canadian dollar to the U.S. dollar, as prices for the Partnership's products are denominated in U.S. dollars or linked to prices quoted in U.S. dollars. Therefore, an increase in the value of the Canadian dollar relative to the U.S. dollar reduces the amount of revenue in Canadian dollar terms realized by the Partnership from sales made in U.S. dollars, which in turn, reduces the Partnership's operating margin and the cash flow available to fund distributions.

DEPENDENCE ON CANFOR

Approximately 65% of the fibre currently used by the Partnership is derived from the Fibre Supply Agreement with Canfor. The Partnership's financial results could be materially adversely affected if Canfor is unable to provide the current volume of wood chips as a result of mill closures, whether temporary or permanent.

RAW MATERIAL COSTS

The principal raw material utilized by the Partnership in its manufacturing operations is wood chips. The Partnership's Fibre Supply Agreement with Canfor contains a pricing formula that currently results in the Partnership paying market prices for wood chips and contains provisions to adjust the pricing formula to reflect market conditions. Prices for wood chips are not within the Partnership's control and are driven by market demand, product availability, environmental restrictions, logging regulations, the imposition of fees or other restrictions on exports of lumber into the U.S. and other matters. The Partnership is not always able to increase the selling prices of its products in response to increases in raw material costs.

COMPETITIVE MARKETS

The Partnership's products are sold primarily in North America, Europe, and Asia. The markets for the Partnership's products are highly competitive on a global basis, with a number of major companies competing in each market with no company holding a dominant position. Competitive factors include quality of product, reliability of supply and customer service. The Partnership's competitive position is influenced by the availability, quality and cost of raw materials, energy and labour costs, free access to markets, currency exchange rates, plant deficiencies and productivity in relation to its competitors.

DEPENDENCE ON KEY CUSTOMERS

In 2006, the Partnership's largest customer accounted for approximately 23% of its pulp sales. The Partnership is, therefore, dependent on this key customer. While the Partnership's relationship with this customer is long-standing and the sales agreement with this customer is evergreen with a three-year notice period required to terminate the Agreement, in the event that the Partnership cannot maintain this customer or the demand from this customer diminishes for any reason in the future, there is a risk that the Partnership would be forced to find alternative markets in which to sell its pulp, which, in turn, could result in lower prices or increased distribution costs thereby adversely affecting its sales margins and distributable cash.

INCREASED PRODUCTION CAPACITY

The Partnership currently faces substantial competition in the pulp industry and may face increased competition in the years to come if new manufacturing facilities are built or existing mills are improved. If increases in pulp production capacity exceed increases in pulp demand, selling prices for pulp could decline and adversely affect the Partnership's business, financial condition, results of operation and cash flows, and the Partnership may not be able to compete with competitors who have greater financial resources and who are better able to weather a prolonged decline in prices.

OBLIGATIONS TO BC HYDRO

Under the Cogeneration Agreement with BC Hydro, if the cogeneration project generates less than 390 GWh in any year and the shortfall cannot be made up by excess generation of up to 390 GWh in prior years or excess generation in the subsequent year, the Partnership is required to pay BC Hydro an amount equal to \$3.27 million multiplied by the ratio of the uncorrected shortfall to the annual requirement of 390 GWh.

MAINTENANCE OBLIGATIONS AND FACILITY DISRUPTIONS

The Partnership's manufacturing processes are vulnerable to operational problems that can impair the Partnership's ability to manufacture its products. The Partnership could experience a breakdown in any of its machines, or other important equipment, and from time to time the Partnership schedules planned and unplanned outages to conduct maintenance that cannot be performed safely or efficiently during operations. Such disruptions could cause significant loss of production, which could have a material adverse effect on the Partnership's business, financial condition and operating results.

GOVERNMENTAL REGULATION

The Partnership is subject to a wide range of general and industry-specific environmental, health and safety and other laws and regulations imposed by federal, provincial and local authorities. If the Partnership is unable to extend or renew a material approval, licence or permit required by such laws, or if there is a delay in renewing any material approval, licence or permit, the Partnership's business, financial condition, results of operations and cash flows could be materially adversely affected. In addition, future events such as any changes in these laws and regulations or any change in their interpretation or enforcement, or the discovery of currently unknown conditions, may give rise to unexpected expenditures or liabilities.

CAPITAL REQUIREMENTS

The pulp and paper industries are capital intensive, and the Partnership regularly incurs capital expenditures to expand its operations, maintain its equipment, increase its operating efficiency and comply with environmental laws. The Partnership's total capital expenditures were approximately \$20 million during 2006, and it expects to spend about \$29 million on capital expenditures during 2007. The Partnership anticipates available cash resources and cash generated from operations will be sufficient to fund its operating needs and capital expenditures.

WORK STOPPAGES

Any labour disruptions and any costs associated with labour disruptions at the Partnership's mills could have a material adverse effect on the Partnership's production levels and results of operations. The Partnership's collective agreements with the CEP and PPWC have terms expiring on April 30, 2008. Any future inability to negotiate acceptable contracts could result in a strike or work stoppage by the affected workers and increased operating costs as a result of higher wages or benefits paid to unionized workers.

NATIVE LAND CLAIMS

Much of the fibre used by the Partnership is sourced from areas, which are located within areas where there are claims of Aboriginal rights and title. The courts have held that the Crown has an obligation to consult aboriginal people, and accommodate their concerns, where there is a reasonable possibility that a Crown-authorized activity, such as public forest tenure, may infringe asserted Aboriginal rights or title, even if those claims have not yet been proven. If the Crown has not consulted and accommodated aboriginal people as required, the courts may quash a tenure or attach conditions to the exercise of harvesting rights under the tenure that may affect the quantity of fibre that can be harvested from such tenure.

TRANSPORTATION SERVICES

The Partnership relies primarily on third parties for transportation of its products, as well as delivery of raw materials principally by railroad, trucks and ships. If any of the Partnership's third party transportation providers were to fail to deliver the raw materials or products or distribute them in a timely manner, the Partnership may be unable to sell those products at full value, or at all, or unable to manufacture its products in response to customer demand and have a material adverse effect on its financial condition and operating results. In addition, if any of these third parties were to cease operations or cease doing business with the Partnership, the Partnership may be unable to replace them at reasonable cost.

SENIOR MANAGEMENT

The Partnership's success depends, in part, on the efforts of its senior management. The senior management team has significant industry experience and would be difficult to replace. Members of the senior management team possess sales, marketing, engineering, manufacturing, financial and administrative skills that are critical to the operation of the Partnership's business. If the Partnership loses or suffers an extended interruption in the services of one or more of its senior officers, the Partnership may become unable to implement its business strategy, resulting in lower profitability. Moreover, the market for qualified individuals is highly competitive, and the Partnership may not be able to attract and retain qualified personnel to replace or succeed members of senior management should the need arise. The Partnership does not maintain any key-man or similar insurance policies covering any of its senior management.

ENVIRONMENTAL ISSUES

In October 2006, the Partnership observed dark ponded water in an area on the banks of the Fraser River and reported the dark ponded water to the appropriate regulatory agencies. The Partnership also undertook certain remedial work and investigations to determine the source of the dark ponded water. The Partnership's experts have concluded that the source is likely a leak from the Partnership's Intercon mill ash pond.

The Partnership in conjunction with the BC Ministry of Environment is considering and developing remedial options. The cost to remediate the ash pond and surrounding area cannot be determined at this time, but the Partnership believes it will not have a material effect on its financial condition.

SENSITIVITIES

In addition, the sensitivity of Partnership's results to currency fluctuations and price changes for its principal products and input costs, when operating at full capacity, is estimated to be as follows:

(millions of dollars, unaudited)	Impact on annual Net income
Canadian dollar – US\$0.01 change per Canadian dollar	\$ 5
NBSK pulp – US\$10 change per tonne	\$ 8
Natural gas cost – \$1 change per gigajoule	\$ 4
Chip cost – \$10 change per tonne	\$ 24

DISCLOSURE CONTROLS

The Partnership has established disclosure controls and procedures to provide reasonable assurance that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Board and the Audit Committee of the General Partner and the Audit Committee and Trustees of the Fund. The Partnership's Chief Executive Officer and Chief Financial Officer have evaluated and are satisfied with the effectiveness of these disclosure controls and procedures for the period ending December 31, 2006.

During 2006 there were no changes to our internal controls over financial reporting that occurred that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

ADDITIONAL INFORMATION

Additional information about Canfor Pulp Income Fund and Canfor Pulp Limited Partnership, including the Annual Information Form, is available at www.sedar.com or www.canforpulp.com.

■ CANFOR PULP LIMITED PARTNERSHIP
SUPPLEMENTARY FINANCIAL INFORMATION

Six months ended December 31

(millions of dollars, unaudited)

2006

RECONCILIATION OF NET INCOME TO EBITDA

Net Income	\$ 86.7
Add:	
Amortization	25.4
Interest	3.8
Foreign exchange loss on long-term debt	2.5
Business acquisition costs and other	6.0
EBITDA (operating income before interest and amortization)	\$ 124.4

CALCULATION OF DISTRIBUTABLE CASH

Cash flow from operating activities	\$ 99.9
Change in working capital	22.8
Deduct:	
Financing costs	(1.6)
Capital expenditures	(11.1)
Distributable cash	\$ 110.0
Distributable cash – per Partnership unit (in dollars)	1.54
Cash distributions declared (paid and payable)	88.5
Cash distributions declared – per Partnership unit (in dollars)	\$ 1.24

Note: Distributable cash is only presented for the periods subsequent to inception of the Partnership's business on July 1, 2006.

DISTRIBUTABLE CASH AND CASH DISTRIBUTIONS

Management determines the level of cash distributions based on the level of cash flow from operations before working capital changes less actual and planned capital expenditures and a reserve for future major capital replacements (estimated at \$4 million per year) less a contingency reserve. During the year distributions are based on estimates of full year cash flow and capital spending and thus distributions may be adjusted as these estimates change. Capital expenditures during 2006, including the second half of the year, were below the level normally expected for the business and as a result the reserve for capital expenditures for the balance of the year was increased to provide a reserve for spending in future periods. It is expected that normal seasonal fluctuations in working capital will be funded from a revolving short-term credit facility and thus will not significantly affect the level of distributions.

Distributions are declared on a monthly basis with record date on the last day of the month and payable within 15 days following. The Partnership began active operation in July 2006, including monthly distributions, and thus there were no distributions in prior periods and no distributions will be paid for earnings from prior periods. The calculation of distributable cash in the table above for any periods prior to July 1, 2006 is provided for information purposes only.

EBITDA and distributable cash are not measures determined in accordance with Canadian generally accepted accounting principles and should not be considered as alternatives to net income or cash flow from operations. As there is no standardized method of calculating EBITDA or distributable cash, the Partnership's use of these terms may not be directly comparable with similarly titled measures used by other companies or income funds.

■ CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY

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

The Partnership and the Fund maintain systems of internal accounting controls, policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of its assets. Canfor's Internal Audit Department performs independent reviews of the accounting records and related procedures. The Internal Audit Department reports its findings and recommendations both to Management and the Audit Committee.

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

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

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



Paul Richards
President and CEO
Canfor Pulp Holding Inc.

The General Partner of Canfor Pulp Limited Partnership



Thomas Sitar
Chief Financial Officer and Secretary
Canfor Pulp Holding Inc.

The General Partner of Canfor Pulp Limited Partnership

AUDITORS' REPORT

To the Unitholders of Canfor Pulp Income Fund

We have audited the consolidated balance sheet of Canfor Pulp Income Fund (the "Fund") as at December 31, 2006, and the consolidated statements of income and accumulated earnings and distributions and cash flows for the period from July 1, 2006 (commencement of commercial operations of the Fund) to December 31, 2006. These consolidated financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006, and the results of its operations and its cash flows for the period ended December 31, 2006 in accordance with Canadian generally accepted accounting principles and as described in Note 1 to the consolidated financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, BC

February 16, 2007

PricewaterhouseCoopers refers to the Canadian firm of PricewaterhouseCoopers LLP and the other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

■ CANFOR PULP INCOME FUND
CONSOLIDATED STATEMENT OF INCOME AND ACCUMULATED EARNINGS AND DISTRIBUTIONS

Six months ended December 31

(thousands of dollars, except unit and per unit amounts)

2006

Income	
Equity income in Canfor Pulp Limited Partnership	\$ 20,558
Expenses	
Operating expenses (notes 4, 6)	-
Net Income	
Distributions declared (note 4)	30,419
Accumulated distributions in excess of earnings, end of period	\$ (9,861)
Weighted average number of units	
Net income per unit, basic and diluted	\$ 1.15

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

■ CANFOR PULP INCOME FUND
 CONSOLIDATED CASH FLOW STATEMENT

6 months ended December 31

(thousands of dollars)	2006
Cash generated from (used in)	
Operating activities	
Net income	\$ 20,558
Items not affecting cash:	
Equity income in Canfor Pulp Limited Partnership	(20,558)
Net change in non-cash working capital	-
	-
Financing activities	
Distributions paid to unitholders	\$ (17,641)
Investing activities	
Distributions received from Canfor Pulp Limited Partnership	17,641
Beginning, change and ending balance in cash and cash equivalents	\$ -

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

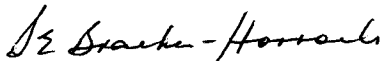
■ CANFOR PULP INCOME FUND
 CONSOLIDATED BALANCE SHEET

As at December 31

(thousands of dollars)	2006
ASSETS	
Current Assets	
Distributions receivable from Canfor Pulp Limited Partnership	\$ 12,778
Total current assets	12,778
Equity Investment in Canfor Pulp Limited Partnership (note 3)	289,491
	\$ 302,269
LIABILITIES	
Current Liabilities	
Accounts payable (note 6)	\$ 1
Distribution payable (note 4)	12,778
	\$ 12,779
UNITHOLDERS' EQUITY	
Unitholders' Equity (note 5)	\$ 299,351
Accumulated distributions in excess of earnings – from inception July 1, 2006	(9,861)
	289,490
	\$ 302,269

Description of the fund and basis of presentation of financial statements (note 1)
 Subsequent events (note 8)
 The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Trustees


 Stan Bracken-Horrocks
 Trustee


 Charles Jago
 Trustee

■ CANFOR PULP INCOME FUND

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS AS AT DECEMBER 31, 2006

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 the Province 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.

These consolidated financial statements include the accounts of the Fund and the Trust. From the date of its establishment on April 21, 2006 to June 30, 2006, the Fund was inactive. As a result, there are no comparative figures in the financial statements for any periods prior to the six months ended December 31, 2006.

On July 1, 2006, the Fund completed the indirect acquisition of 20% of the Prince George, BC based NBSK pulp and paper business of Canfor Corporation (Canfor). Canfor exchanged 14,254,005 Class A Limited Partnership Units for an equal number of Fund units and these units were then distributed by Canfor to its shareholders. As a result of these transactions, on July 1, 2006, Canfor shareholders owned all of the issued and outstanding Fund units, and the Fund held all issued and outstanding Class A Limited Partnership Units representing a 20% indirect interest in the Partnership.

On November 30, 2006, Canfor exchanged 21,239,537 Class B Exchangeable Limited Partnership Units of the Partnership for the same number of newly issued Fund units and immediately distributed these Fund units to its shareholders as an in-kind taxable dividend of 1.49 units for every 10 Canfor shares held. Following completion of this exchange, there are a total of 35,493,542 Fund units issued and outstanding, and the Fund indirectly holds a total of 35,493,542 units of the Partnership, representing 49.8% of the Partnership. Canfor, through its ownership of Class B Exchangeable Limited Partnership Units, which are indirectly exchangeable for Fund units, owns the remaining 50.2% interest in the Partnership. As a result of the transaction, and the Fund's method of accounting for its investment in the Partnership, the Fund recognized its 20% pro-rata earning of the Partnership's November income, however, based on the distribution declared by the Partnership on November 30, 2006, the Fund received 49.8% of the total November cash distribution. The Fund has recognized the distribution received in excess of its pro-rata share of the Partnership's income (\$5.1 million or 29.8% of the distribution) as a permanent contribution by Canfor through its ownership in the Partnership.

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

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

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

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

INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

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

USE OF ESTIMATES

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

NET INCOME PER UNIT

Basic net income per Fund unit is based on the weighted average number of Fund units outstanding during the period. At December 31, 2006 the Partnership has 35,776,483 Class B Exchangeable Limited Partnership Units outstanding which can be exchanged for Fund units at the option of the holder (Canfor). Any issuance of new Fund units would be accompanied with a corresponding increase in the Fund's investment in the Partnership through the acquisition of Class B Exchangeable Limited Partnership Units. As a result, this potential conversion would not result in any dilution of the Fund's net income per unit.

INCOME TAXES

The Fund is a unit trust for income tax purposes. As such, the Fund is only taxable on any taxable income not allocated to the unitholders. For the six months ended December 31, 2006, all taxable income of the Fund will be allocated to the unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the unitholders.

3. EQUITY INVESTMENT IN CANFOR PULP LIMITED PARTNERSHIP

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

(thousands of dollars)

Initial investment in the Partnership on July 1, 2006 – 14,254,005 Fund units	\$ 116,560
Issuance of Fund units for exchangeable Partnership units (November 30, 2006) – 21,239,537 Fund units	182,792
Cumulative equity in income of the Partnership	20,558
Cumulative distributions received and receivable	(30,419)
Equity investment in the Partnership as at December 31, 2006	\$ 289,491

The Fund's investment in the Partnership units is recorded using the equity method. The Fund's initial investment in the Partnership on July 1, 2006 represented the Fund's 20% ownership in the transfer of the Pulp and Paper business from Canfor to the Partnership. On November 30, 2006 Canfor exchanged 21,239,537 Class B Exchangeable Limited Partnership Units for the same number of newly issued Fund units for a total value of \$182.8 million (\$8.61 per unit), representing the Fund's pro-rata share of the carrying value of the Partnership units received on the date of the exchange.

4. DISTRIBUTIONS

The Fund declared distributions in its first six months of operation as follows:

(thousands of dollars, except per unit amounts)		Amount per Fund Unit			Amount
Record Date	Payable Date	Monthly	Supplemental	Total	
August 2, 2006	August 15, 2006	\$ 0.12	\$ -	\$ 0.12	\$ 1,710.5
August 31, 2006	September 15, 2006	0.12	-	0.12	1,710.5
September 29, 2006	October 13, 2006	0.12	0.08	0.20	2,850.8
October 31, 2006	November 15, 2006	0.12	0.08	0.20	2,850.8
November 30, 2006	December 15, 2006	0.12	0.12	0.24	8,518.3
December 29, 2006	January 15, 2007	0.14	0.22	0.36	12,777.6
Total		\$ 0.74	\$ 0.50	\$ 1.24	\$30,418.5

The Fund's monthly distributions are based on the Partnership's monthly distributions. To December 31, 2006, distributions declared by the Fund equaled those declared by the Partnership with the exception of an expense distribution declared by the Partnership totaling \$142,000 payable to the Fund. The expense distribution is accounted for as a recovery of operating expenses and presented on a net basis in the consolidated statement of income and accumulated earnings and distributions. This amount represents the Partnership's commitment to cover the Fund's operating expenses pursuant to the Partnership agreement.

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

5. UNITHOLDERS' EQUITY

The Fund may issue an unlimited number of Fund units for consideration, and on the terms and conditions determined by the Trustees. Each Fund unit is transferable and represents an equal and undivided beneficial interest in any distributions from the Fund. All Fund units are of the same class and have equal rights and privileges.

On initial distribution on July 1, 2006, the total number of Fund units issued was 14,254,005, equal to the number of Class A Limited Partnership Units for which they were exchanged.

On November 30, 2006 the Fund completed the issuance of 21,239,537 Fund units for a total value of \$182.8 million (\$8.61 per unit) representing the Fund's pro-rata share of the carrying value of the Partnership units received on the date of the exchange. Following completion of this exchange, there are a total of 35,493,542 Fund units issued and outstanding.

REDEMPTION RIGHTS

Fund units are redeemable at any time on demand by the holders thereof upon delivery to the Fund of a duly completed and properly executed notice requesting redemption in a form approved by the Fund Trustees. Upon receipt of the redemption notice by the Fund, all rights with respect to the Fund units tendered for redemption, including the right to receive any distributions which are declared payable to the unitholders of record on a date subsequent to the date of receipt by the Fund of such notice, will be surrendered and the unitholder will be entitled to receive a price per Fund unit equal to the lesser of 90% of the market price of the Fund units as of the date on which the Fund units are surrendered for redemption (Redemption Date); and 100% of the closing market price on the Redemption Date.

EXCHANGE RIGHTS

Canfor holds all remaining (35,776,483) Class B Exchangeable Limited Partnership Units, and it has the ability to indirectly exchange them on a one-for-one basis into Fund units.

6. RELATED PARTY TRANSACTIONS

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf by the Partnership pursuant to a support agreement. For the six months ended December 31, 2006, the Fund had incurred operating expenses with third parties of \$142,000. During the fourth quarter, the Partnership declared an expense distribution to cover the operating expenses of the Fund as provided for in the Partnership agreement. The expense distribution is accounted for as a recovery of operating expenses and presented on a net basis in the consolidated statement of income and accumulated earnings and distributions.

7. TAXATION OF PUBLICLY TRADED INCOME TRUSTS

Income tax obligations related to the distributions of the Fund are the obligations of the unitholders.

On October 31, 2006, the Canadian Federal Government announced proposed plans to apply a tax on distributions from publicly traded income trusts, such as the Fund. For existing income trusts the government is proposing a four-year transition period until their 2011 taxation year before the tax would be applicable. The impact to the Fund is unknown at this time and may be material.

8. SUBSEQUENT EVENTS

On January 24, 2007 the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on February 15, 2007 to unitholders of record on January 31, 2007. On February 16, 2007, the Fund declared a distribution of \$0.14 per unit or \$5.0 million, payable on March 15, 2007 to unitholders of record on February 28, 2007.

AUDITORS' REPORT

To the Partners of Canfor Pulp Limited Partnership

We have audited the consolidated balance sheets of Canfor Pulp Limited Partnership (the "Partnership") as at December 31, 2006 and December 31, 2005, and the consolidated statements of income and Partners' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2006 and December 31, 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles and as described in Note 1 to the consolidated financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, BC

February 16, 2007

PricewaterhouseCoopers refers to the Canadian firm of PricewaterhouseCoopers LLP and the other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

■ CANFOR PULP LIMITED PARTNERSHIP
CONSOLIDATED STATEMENTS OF INCOME AND PARTNERS' EQUITY

Year ended December 31

(millions of dollars)	2006	2005
Sales	\$ 834.4	\$ 771.2
Costs and expenses		
Manufacturing and product costs	512.7	569.6
Freight and other distribution costs	114.1	116.0
Amortization	49.0	47.2
Selling and administration costs	23.5	21.7
	699.3	754.5
Operating income	135.1	16.7
Business acquisition costs <small>(note 3)</small>	(5.9)	-
Interest expense, net	(3.8)	-
Foreign exchange loss on long-term debt	(2.5)	-
Other income (expenses)	0.1	(0.2)
	(12.1)	(0.2)
Net income	\$ 123.0	\$ 16.5
Net income per Partnership unit <small>(in dollars) (note 10)</small>		
Basic and diluted	\$ 1.73	\$ 0.23
Weighted average Partnership units outstanding	71,270,025	71,270,025
Partners' equity, beginning of period	\$ 728.7	\$ 740.0
Issuance of promissory note on acquisition <small>(notes 3 & 4)</small>	(125.0)	-
Net transactions with Canfor <small>(note 1)</small>	(57.2)	(27.8)
Net income for the period	123.0	16.5
Distributions to partners <small>(notes 13 & 16)</small>	(88.5)	-
Partners' equity, end of period	\$ 581.0	\$ 728.7

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

■ CANFOR PULP LIMITED PARTNERSHIP
CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31

(millions of dollars)	2006	2005
Cash and cash equivalents generated from (used in)		
Operating activities		
Net income	\$ 123.0	\$ 16.5
Items not affecting cash:		
Amortization	49.0	47.2
Unrealized foreign exchange loss on long-term debt	2.5	-
Employee future benefits	7.5	4.2
Other	(3.3)	-
Cash flow from operations before working capital changes	178.7	67.9
Changes in non-cash working capital ^(note 12)	(10.5)	2.1
	168.2	70.0
Financing activities		
Repayment of promissory note	(125.0)	-
Proceeds of long-term debt	125.7	-
Financing costs	(1.6)	-
Net transactions with Canfor	(57.2)	(27.8)
	(58.1)	(27.8)
Investing activities		
Property, plant and equipment, net	(19.6)	(43.0)
Distributions paid to partners ^(note 13)	(62.7)	-
	(82.3)	(43.0)
Increase (decrease) in cash and cash equivalents	27.8	(0.8)
Cash and cash equivalents, beginning of period	0.6	1.4
Cash and cash equivalents, end of period	\$ 28.4	\$ 0.6
Cash payments in the period		
Interest, net	\$ 2.4	\$ -

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

■ CANFOR PULP LIMITED PARTNERSHIP
CONSOLIDATED BALANCE SHEETS

Year ended December 31

(millions of dollars)	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 28.4	\$ 0.6
Accounts receivable (note 9)		
Trade	130.9	127.9
Other	6.7	10.0
Inventories (note 6)	111.0	107.0
Prepaid expenses	13.1	4.9
Total current assets	290.1	250.4
Property, plant and equipment (note 8)	598.6	627.9
Deferred charges	4.7	0.1
	\$ 893.4	\$ 878.4
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities (note 9)	\$ 125.5	\$ 124.0
Distributions payable (note 13)	25.8	-
Total current liabilities	151.3	124.0
Long-term debt (note 4)	128.2	-
Long-term accruals and liabilities (note 5)	32.9	25.7
	\$ 312.4	\$ 149.7
PARTNERS' EQUITY		
Capital - 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (notes 1 & 3)	\$ 581.0	\$ 728.7
Total Partners' Equity	581.0	728.7
	\$ 893.4	\$ 878.4

Commitments and contingencies (note 14)

Subsequent events (note 16)

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

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



Stan Bracken-Horrocks
Director



Paul Richards
Director

■ CANFOR PULP LIMITED PARTNERSHIP

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS AS AT DECEMBER 31, 2006 & 2005

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).

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Exchangeable Limited Partnership Units (the Spinout). Canfor then exchanged its Class A Limited Partnership Units for an equal number of units of Canfor Pulp Income Fund (the Fund). Finally Canfor distributed to its shareholders, for each Canfor share held by them, one New Common Share of Canfor and 0.1 of a unit of the Fund (Fund unit), with the distribution of the Fund units being structured as a return of capital on the Canfor shares. As a result, on the date of the Spinout, Canfor shareholders owned all of the issued and outstanding Fund units, with the outstanding Fund units representing a 20% indirect interest in the Partnership and thus the Pulp Business. On November 30, 2006, Canfor exercised its right to exchange Class B Exchangeable Limited Partnership Units for Fund units and 21,239,537 units were exchanged. The exchange was made in order to provide Canfor with the Fund units necessary to enable it to pay a dividend-in-kind to its shareholders. Following completion of this exchange Canfor owns 50.2% and the Fund indirectly owns 49.8% of the issued and outstanding units of the Partnership.

The general partner of the Partnership is Canfor Pulp Holding Inc. (the General Partner), which holds an interest of 0.001% of the Partnership.

All pulp produced by the Pulp Business is sold by the Pulp Business' sales and marketing group to customers primarily in North America, Europe and Asia. The kraft paper produced by the Pulp Business is sold by a 50% owned general partnership to customers in North America and Europe.

For all periods ending prior to July 1, 2006, these financial statements present the financial position, results of operations, and cash flows of the Pulp Business on a carve out basis from Canfor as if operated as a stand-alone partnership entity subject to Canfor control. As a result, the transaction has been accounted for as a continuity of interests. The accompanying financial statements include allocations of Canfor's assets, liabilities and costs. The financial condition, results of operations, and cash flows of the Pulp Business for these comparative periods are not necessarily indicative of the financial condition, results of operations or cash flows that would have been incurred if the Pulp Business was a separate legal entity. Prior to July 1, 2006, the Pulp Business did not operate bank accounts independent or separate from Canfor (other than for marketing subsidiaries) and, as a result and for purposes of prior periods, the combined effect of all transactions is reflected in the net transactions with Canfor line in the Partners' equity.

The statements of income for all periods prior to July 1, 2006, include selling and administration expenses of the Pulp Business, as historically reported in Canfor's financial statements, that have been allocated to the Pulp Business based on specific identification and, where specific identification has been deemed impractical, on a basis which management believes reasonably reflects the cost of services provided. Employee benefits, consisting of such costs as pension, health and welfare and payroll taxes are based on a percentage of actual payroll or allocated payroll charges to the Pulp Business. Amortization is based upon specific identification of the assets utilized in the Pulp Business. Allocated corporate expenses have been charged to the Pulp Business based on specific identification or, when this is deemed impractical, on a basis that management believes reasonably reflects the cost of services provided. Management believes these expense allocations adequately reflect the estimated cost of services provided but may not necessarily be indicative of actual costs that would have been incurred if Canfor had not provided these services.

The balance sheet at December 31, 2005, includes all assets and liabilities directly attributable to the Pulp Business including an allocation of Canfor's corporate assets and liabilities. Employee future benefit liabilities include the obligations for health care and other non-pension benefits for the active salaried employees and active and retired hourly employees of the Pulp Business. The Pulp Business participated in the centralized cash management systems of Canfor, and as a result, did not have separate bank accounts, except for cash held in international marketing operations.

These 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.

ECONOMIC DEPENDENCE

The Partnership depends on Canfor to provide approximately 65% of its fibre supply as well as to provide certain key business and administrative services as described in note 9. As a result of these relationships as well as other relationships described throughout these financial statements, the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

2. SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION

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

USE OF ESTIMATES

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

Significant areas requiring the use of management estimates are, inventory valuations, amortization rates, employee benefit plan assumptions, and environmental obligations.

CASH AND CASH EQUIVALENTS

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

VALUATION OF INVENTORIES

Inventories of pulp and paper products are valued at the lower of average cost and net realizable value. Wood chips are valued at the lower of: a) average cost or b) the greater of net realizable value and replacement cost. Processing materials and supplies are valued at the lower of average cost and replacement cost.

PROPERTY, PLANT AND EQUIPMENT

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

Assets are amortized over the following estimated productive lives:

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

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

EMPLOYEE FUTURE BENEFITS

The Partnership provides certain health care benefits and pension bridge plans to eligible retired employees. The Partnership accrues the costs and related obligations of the pension bridge plan and other retirement benefit plans using the projected benefit actuarial method pro-rated on service and management's best estimates of salary escalation and other relevant factors. Actuarial gains (losses) arise from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees, which is 16 years for the pension bridge plan and 14 years for the other benefit plans. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment. On January 1, 2000, the Pulp Business (Canfor) adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to the accounting for pensions and other post-employment benefits using the prospective application method. The Partnership is amortizing the transitional obligation on a straight-line basis over 16 years, which was the average remaining service period of employees expected to receive benefits under the benefit plan as of January 1, 2000.

The Partnership participates, together with Canfor, in a group defined benefit plan (Group Plan) providing pension benefits to most of its salaried employees. The assets of the Group Plan are not segregated for each participating entity and are used to provide pensions to all members of this plan. As a result, the Partnership is required to account for the Group Plan as a multi-employer plan whereby contributions are expensed as paid. Certain offshore marketing entities provide pension benefits for salaried employees and these obligations are recorded in the liabilities of the Partnership.

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

REVENUE RECOGNITION

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

FOREIGN CURRENCY TRANSLATION

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

DERIVATIVE FINANCIAL INSTRUMENTS

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

The Partnership formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities or to specific firm commitments or forecasted transactions. The Partnership also formally assesses, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items.

Gains and losses on forward foreign exchange contracts which qualify as a hedge of U.S. dollar denominated sales are recognized as an adjustment to revenue at the time that the contracts are settled. Gains and losses on natural gas swaps which qualify as a hedge and are recognized as an adjustment to manufacturing costs when the contracts are settled.

IMPAIRMENT OF LONG-LIVED ASSETS

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

INCOME TAXES

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

CHANGE IN ACCOUNTING POLICY – MAJOR MAINTENANCE COSTS

The Partnership adopted the deferral method of accounting for major maintenance costs. Under this method an asset is recorded when expenditures for maintenance costs related to major maintenance are incurred. This asset is then amortized over the period to which the maintenance relates. The amounts in prior periods are not considered material for restatement.

3. BUSINESS ACQUISITION COSTS AND PARTNERS' EQUITY

The Partnership incurred costs related to its initial organization and the acquisition of the Pulp Business from Canfor principally comprised of legal, accounting, audit and consulting fees.

Prior to the transfer the net value of the Pulp Business is reflected in Partners' Equity. On July 1, 2006 the Pulp Business was transferred to the Partnership at Canfor's book value as follows:

Net assets transferred

(millions of dollars)

Non cash working capital	\$ 124.7
Property, plant and equipment	612.9
Other accruals and liabilities	(29.8)
	\$ 707.8

Consideration provided

(millions of dollars)

Promissory note	\$ 125.0
Partners' equity	582.8
	\$ 707.8

4. CREDIT FACILITIES AND LONG-TERM DEBT

On November 30, 2006, the Partnership completed a debt financing by private placement of US\$110 million (Cdn\$125.7 million) of unsecured notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013. The proceeds from the issuance of the Notes were used to repay the \$125 million Canfor promissory note.

The Partnership also entered into a 3-year \$75 million syndicated unsecured revolving bank credit facility (the Revolving Facility) with \$30.6 million of the Revolving Facility reserved for a standby letter of credit issued to BC Hydro (note 14). 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, U.S. base rate or U.S. LIBOR rate.

Each agreement relative to the Notes and Revolving Facility contains the same covenants with respect to certain financial ratios and at December 31, 2006 the Partnership was in compliance with all covenants.

The fair value of long-term debt at December 31, 2006 was \$127.4 million (US\$109.3 million).

5. LONG-TERM ACCRUALS AND LIABILITIES

(millions of dollars)	2006	2005
Accrued pension obligations	\$ 2.7	\$ 0.9
Post-employment benefits	30.2	24.8
	\$ 32.9	\$ 25.7

6. INVENTORIES

(millions of dollars)	2006	2005
Pulp	\$ 48.9	\$ 42.2
Paper	11.6	11.4
Wood chips	5.4	9.0
Processing materials and supplies	45.1	44.4
	\$ 111.0	\$ 107.0

7. EMPLOYEE FUTURE BENEFITS

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

The expense recognized in the year for providing the pension and post-employment benefits was as follows:

(millions of dollars)	2006	2005
Pension plans	\$ 4.4	\$ 4.7
Other employee future benefit plans	6.1	4.9
Contributions to forest industry union plans	6.2	6.3
	\$ 16.7	\$ 15.9

The assets of the salaried employees defined benefit plan are combined with those of Canfor (a multi-employer plan) and are not segregated for each participating entity. Accordingly, the assets and benefit obligations are not recorded on the balance sheet of the Partnership and contributions are expensed as paid. In the event that the Partnership ceased to participate in the multi-employer plan, the funded status of the pension obligations would be dependent on the amount of assets transferred to the Partnership at the time of segregation, and therefore cannot be determined at this time.

BENEFIT PLANS

The Partnership measures its accrued benefit obligations for accounting purposes as at September 30 of each year. The most recent actuarial valuations for the post-employment benefit plan and the pension bridge plan were on September 30, 2004 and September 30, 2005, respectively.

Information about the Partnership's non-pension retirement benefits is as follows:

BENEFIT PLAN OBLIGATIONS

(millions of dollars)	2006		2005	
	Post-Employment Benefit Plan	Pension Bridge Plan	Post-Employment Benefit Plan	Pension Bridge Plan
Accrued benefit obligation				
Beginning of year	\$ 53.2	\$ 4.7	\$ 39.4	\$ 3.8
Current service cost	1.4	0.2	1.1	0.2
Interest cost	2.9	0.3	2.6	0.2
Benefit payments	(0.6)	-	(0.6)	-
Plan amendments	-	1.4	-	-
Actuarial loss (gain)	(1.1)	3.0	10.7	0.5
End of year	\$ 55.8	\$ 9.6	\$ 53.2	\$ 4.7

RECONCILIATION OF THE FUNDED STATUS OF THE BENEFIT PLANS TO THE AMOUNTS RECORDED IN THE FINANCIAL STATEMENTS

(millions of dollars)	2006		2005	
	Post-Employment Benefit Plan	Pension Bridge Plan	Post-Employment Benefit Plan	Pension Bridge Plan
Fair market value of plan assets	\$ -	\$ -	\$ -	\$ -
Accrued benefit obligation	55.8	9.6	53.2	4.7
Funded status of plans - deficit	(55.8)	(9.6)	(53.2)	(4.7)
Employer contributions after measurement date	0.2	-	0.2	-
Unamortized transitional obligation	7.1	1.8	7.8	1.9
Unamortized past service costs	-	1.4	-	-
Unamortized net actuarial loss	18.3	4.3	20.4	1.4
Accrued benefit liability	\$ (30.2)	\$ (2.1)	\$ (24.8)	\$ (1.4)

The Pension Bridge Plan is a benefit plan for hourly employees as a result of provisions in collective agreements. Under the terms of the agreements this is an unfunded obligation of the employer. Prior to July 1, 2006, obligations under this plan rested with Canfor and the 2005 comparative amounts above are shown for information purposes only.

The Partnership's expense for company-sponsored benefit plans is as follows:

(millions of dollars)	2006	2005
POST-EMPLOYMENT BENEFIT PLAN		
Current service cost, net of employee contributions	\$ 1.4	\$ 1.1
Interest cost	2.9	2.6
Actuarial loss	1.0	0.4
Amortization of transitional obligation	0.8	0.8
	\$ 6.1	\$ 4.9
PENSION BRIDGE PLAN		
Current service cost, net of employee contributions	\$ 0.2	\$ 0.2
Interest cost	0.2	0.2
Actuarial loss	0.1	-
Amortization of transitional obligation	0.2	0.2
	\$ 0.7	\$ 0.6

Note: Amounts for Pension Bridge Plan in table above exclude amounts for employees who retired prior to July 1, 2006, as those are obligations of Canfor.

SIGNIFICANT ASSUMPTIONS

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

(weighted average assumptions)	2006		2005	
	Post-Employment Benefit Plan	Pension Bridge Plan	Post-Employment Benefit Plan	Pension Bridge Plan
Accrued benefit obligation as of December 31:				
Discount rate	5.25%	5.25%	5.25 %	5.25 %
Rate of compensation increase	3.0%	N/A	3.0 %	N/A
Benefit costs for year ended December 31:				
Discount rate	5.25%	5.25%	6.5 %	6.25%
Rate of compensation increase	3.0%	N/A	3.5 %	N/A

ASSUMED HEALTH CARE COST TREND RATES

(weighted average assumptions)	2006	2005
Initial health care cost trend rate	5.87%	6.10%
Ultimate health care trend rate	4.27%	4.28%
Year ultimate rate is reached	2011	2011

SENSITIVITY ANALYSIS

Assumed health care cost trend rates have a significant effect on the amounts reported for the post-employment benefit plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects for 2006:

(millions of dollars)	1% Increase	1% Decrease
Accrued benefit obligation	\$ 12.2	\$ (9.5)
Total of service and interest cost	\$ 0.5	\$ (0.4)

DEFINED CONTRIBUTION AND OTHER PLANS

The total cost recognized in 2006 for the Partnership's defined contribution plan was \$0.2 million (2005 – nil).

The Partnership contributes to forest industry union defined benefit pension plans providing both pension and other retirement benefits. These plans are accounted for as defined contribution plans. Contributions to these plans, not included in the cost recognized for defined contribution plans above, amounted to \$6.2 million in 2006 (2005 – \$6.3 million).

8. PROPERTY, PLANT AND EQUIPMENT

(millions of dollars)	2006		
	Cost	Accumulated amortization	Net
Land	\$ 5.4	\$ –	\$ 5.4
Buildings, machinery and equipment	1,272.6	684.5	588.1
Construction in progress	5.1	–	5.1
	<u>\$ 1,283.1</u>	<u>\$ 684.5</u>	<u>\$ 598.6</u>

(millions of dollars)	2005		
	Cost	Accumulated amortization	Net
Land	\$ 5.2	\$ –	\$ 5.2
Buildings, machinery and equipment	1,248.7	629.3	619.4
Construction in progress	3.3	–	3.3
	<u>\$ 1,257.2</u>	<u>\$ 629.3</u>	<u>\$ 627.9</u>

9. RELATED PARTY TRANSACTIONS

The Partnership's transactions with related parties are based on agreed upon amounts, unless otherwise noted below.

The Partnership purchased wood chips and hog fuel from Canfor sawmills in the amount of \$83.3 million in 2006 (2005 – \$106.2 million). The Partnership also purchased wood chips from Lakeland Mills Ltd. and Winton Global Lumber Ltd., in which Canfor owns a one-third interest. Purchases from these entities in 2006 were \$8.6 million (2005 – \$11.1 million).

Effective July 1, 2006, the Partnership entered into a services agreement under which Canfor provides certain business and administrative services to the Partnership. Total value of the services provided in 2006 was \$8.5 million (2005 – \$11.6 million). The corporate costs in comparative periods prior to the acquisition were based on estimates of the Pulp Business' share of Canfor's corporate costs (note 1).

Effective July 1, 2006, the Partnership entered into an incidental services agreement with Canfor, under which the Partnership provides certain business and administrative services to Canfor. Total value of the services provided in 2006 was \$1.5 million (2005 – \$1.5 million).

The Partnership markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill for which it earned commissions totaling \$2.3 million in 2006 (2005 – \$2.8 million). The Partnership also purchased chemi-thermo mechanical pulp from the Canfor Taylor Pulp Mill for resale totaling \$10.1 million in 2006 (2005 – \$8.0 million). In respect of the products marketed and services provided for the Canfor Taylor Pulp Mill, the Partnership held balances of \$6.3 million in accounts receivable-trade and \$6.6 million in accounts payable to Canfor at December 31, 2006 (2005 – \$8.8 million accounts receivable-trade and \$9.8 million in accounts payable to Canfor).

The Partnership markets the NBSK pulp produced by Howe Sound Pulp and Paper Limited Partnership (HSLP), a partnership 50% owned by Canfor, for which it earned commissions totaling \$4.7 million in 2006 (2005 – \$6.0 million). In respect of the products marketed and service provided for HSLP, the Partnership held balances of \$31.9 million in accounts receivable-trade and \$23.1 million in accounts payable to HSLP at December 31, 2006 (2005 – \$32.3 million in accounts receivable-trade and \$35.6 million in accounts payable to HSLP).

On July 1, 2006, Canfor transferred the Pulp Business to the Partnership in exchange for a \$125 million promissory note, 14.254 million Class A Limited Partnership Units and 57.016 million Class B Exchangeable Limited Partnership Units. The Partnership paid the debt in full on November 30, 2006. Total interest paid or payable to Canfor was \$3.7 million in 2006.

At December 31, 2006, a total of \$14.3 million was outstanding as accounts payable to Canfor in respect of purchases of wood chips, hog fuel, services and amounts paid on behalf of the Partnership. At December 31, 2006 a total of \$0.8 million was payable to Lakeland Mills Ltd. and Winton Global Lumber Ltd. for wood chips (2005 – \$0.7 million).

During 2006, the Partnership declared distributions totaling \$88.5 million to its limited partners. Distributions to Canfor were \$57.9 million, of which \$45.0 million was paid, with the balance of \$12.9 million payable on December 31, 2006. Distributions to the Fund were \$30.6 million, of which \$17.7 million was paid, with the balance of \$12.9 million payable on December 31, 2006.

10. INCOME PER PARTNERSHIP UNIT

Basic 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. For purposes of comparative amounts for periods prior to July 1, 2006, it was assumed that the same number of units was outstanding throughout the comparative periods. There were no other securities with rights to conversion into Partnership units outstanding.

11. FINANCIAL INSTRUMENTS

The Partnership uses a variety of financial instruments to reduce its exposure to risks associated with fluctuations in foreign currency exchange rates, pulp prices and energy costs.

At December 31, 2006, the Partnership had outstanding pulp swaps to hedge 7,500 tonnes (2,500 tonnes per month to March 2007) of future pulp sales at an average price of US\$683 per tonne, along with matching U.S. dollar forward contracts for the exchange of US\$5.1 million at an average rate of 1.1092. There was a combined unrealized loss of \$1.0 million on the pulp swaps and forward contracts at the end of the period.

At December 31, 2006, the Partnership had outstanding commodity swaps hedging future natural gas purchases of 3.6 million gigajoules extending to October 2009 with an unrealized loss of \$0.8 million.

12. CHANGES IN NON-CASH WORKING CAPITAL

(millions of dollars)	2006	2005
Accounts receivable	\$ 0.3	\$ 2.1
Inventories	(4.0)	7.3
Prepaid expenses	(8.2)	1.3
Accounts payable and accrued liabilities	1.4	(8.6)
	\$ (10.5)	\$ 2.1

13. DISTRIBUTIONS

The Partnership declared distributions in its first six months of operation as follows:

(millions of dollars, except per unit amounts)		Amount per Fund Unit			Amount
Record Date	Payable Date	Monthly	Supplemental	Total	
August 2, 2006	August 15, 2006	\$ 0.12	\$ –	\$ 0.12	\$ 8.5
August 31, 2006	September 15, 2006	0.12	–	0.12	8.5
September 29, 2006	October 13, 2006	0.12	0.08	0.20	14.3
October 31, 2006	November 15, 2006	0.12	0.08	0.20	14.3
November 30, 2006	December 15, 2006	0.12	0.12	0.24	17.1
December 29, 2006	January 15, 2007	0.14	0.22	0.36	25.8
Total		\$ 0.74	\$ 0.50	\$ 1.24	\$ 88.5

14. COMMITMENTS AND CONTINGENCIES

The Partnership has committed to the following operating leases for property, plant and equipment. As at December 31, 2006, the future minimum lease payments under these operating leases were as follows:

(millions of dollars)	
2007	\$ 3.0
2008	1.5
2009	0.7
Thereafter	0.5
Total minimum lease payments	\$ 5.7

In 2003, Canfor entered into an agreement with BC Hydro to build an electrical cogeneration facility at the Prince George Pulp and Paper Mill. Under the agreement, BC Hydro contributed \$45.8 million of the project costs, with Canfor contributing the balance. The agreement was assigned to the Partnership effective July 1, 2006, with incentive payments totaling \$11.4 million outstanding. The final incentive payment of \$11.4 million was received August 9, 2006, and transferred to Canfor. The total incentive payments of \$45.8 million were accounted for as a credit to property, plant and equipment of the Partnership. The project was completed in the second quarter of 2005 at a net cost to the Pulp Business of \$69.6 million. The agreement entails a 15 year commitment with BC Hydro for power displacement at the cogeneration facility, whereby a proportionate repayment is required should the facility not generate the minimum of 390 gigawatt hours of electricity per year. Under the agreement, the Partnership is required to post a standby letter of credit as security in annually decreasing amounts as the minimum required amount of electricity is generated.

As of December 31, 2006, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount \$30.6 million was issued to BC Hydro.

15. SEGMENTED INFORMATION^(a)

(millions of dollars)	Pulp	Paper	Unallocated Costs ^(d)	Total
Year ended December 31, 2006				
Sales to external customers ^(b)	\$ 720.9	113.5	-	\$ 834.4
Sales of pulp to paper segment ^(c)	\$ 71.4	(71.4)	-	\$ -
Operating income (loss)	\$ 146.3	3.2	(14.4)	\$ 135.1
Amortization	\$ 45.0	3.8	0.2	\$ 49.0
Capital expenditures	\$ 16.9	0.8	1.9	\$ 19.6
Identifiable assets	\$ 784.2	70.8	38.4	\$ 893.4
Year ended December 31, 2005				
Sales to external customers ^(b)	\$ 653.8	117.4	-	\$ 771.2
Sales to other segments ^(c)	\$ 65.6	(65.6)	-	\$ -
Operating income (loss)	\$ 26.7	3.6	(13.6)	\$ 16.7
Amortization	\$ 43.4	3.8	-	\$ 47.2
Capital expenditures	\$ 42.1	0.3	0.6	\$ 43.0
Identifiable assets	\$ 797.6	77.9	2.9	\$ 878.4

(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 43% (2005 - 40%).

(b) Sales to the two largest customers represented approximately 34% of pulp segment sales (2005 - 37%).

(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.

(d) Unallocated costs represent actual head office administrative costs in the third and fourth quarters of 2006. For all periods prior to July 1, 2006, head office administrative costs were based on allocated Canfor corporate expenses as described in note 1.

16. SUBSEQUENT EVENTS

On January 24, 2007 the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on February 15, 2007 to unitholders of record on January 31, 2007. On February 16, 2007, the Partnership declared a distribution of \$0.14 per unit or \$10.0 million, payable on March 15, 2007, to unitholders of record on February 28, 2007.

TRUSTEES AND DIRECTORS



Peter J.G. Bentley, O.C., LL.D.⁽³⁾
Director
Chairman of the Board
Canfor Corporation
Vancouver, British Columbia



Peter A. Lusztig, CGA⁽¹⁾⁽²⁾
Director
Dean Emeritus, Sauder School of Business,
the University of British Columbia
Vancouver, British Columbia



Stan E. Bracken-Horrocks, FCA⁽¹⁾⁽³⁾
Trustee and Director
Retired Partner of PricewaterhouseCoopers, LLP
Kelowna, British Columbia



Paul A. Richards
Director
President and Chief Executive Officer of
Canfor Pulp Holding Inc.
West Vancouver, British Columbia



Donald W. Campbell⁽¹⁾⁽²⁾
Trustee and Director
Executive Vice-President of CAE Inc.
Montreal, Quebec



James A. Shepherd, P.Eng.
Director
President and Chief Executive Officer of
Canfor Corporation
Surrey, British Columbia



Charles J. Jago, O.C. Ph.D.⁽¹⁾⁽²⁾⁽³⁾
Trustee and Director
Chairman, Canfor Pulp Holding Inc.
Prince George, British Columbia

(1) Member of Audit Committee for the Fund and Partnership.
(2) Member of the Nominating Committee.
(3) Member of the Compensation Committee.

OFFICERS AND MANAGEMENT

OFFICERS



Paul A. Richards
President and Chief Executive Officer
Canfor Pulp Income Holding Inc.
West Vancouver, British Columbia



Thomas Sitar, CA
Chief Financial Officer and Secretary
Canfor Pulp Income Holding Inc.
Vancouver, British Columbia



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

MANAGEMENT TEAM

Dan Brinson
General Manager Northwood Pulp Mill

Craig Garratt
General Manager Fibre Supply

Rick Remesch, CA
Corporate Controller

Brett Robinson
General Manager Intercontinental and
Prince George Pulp and Paper Mills

David Scott
General Manager, Human Resources

■ COMPANY INFORMATION

Annual General Meeting

Canfor Pulp Income Fund's Annual General Meeting will be held at the Hyatt Regency Hotel, Stanley Room, 655 Burrard Street, Vancouver, BC, on Tuesday, May 1, 2007 at 11:30 a.m.

Transfer Agent and Registrar

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

Stock Listing

Toronto Stock Exchange
Symbol: CFX.UN

Investor Contact

David Jan
Manager, Investor Relations
Telephone: (604) 661-5424
Fax: (604) 661-5429
Email: david.jan@canfor.com

Auditors

PricewaterhouseCoopers LLP
Vancouver, BC

Canfor Pulp Income Fund Head Office

1700 West 75th Avenue
Vancouver, BC
V6P 6G2

Telephone: (604) 661-5241
Fax: (604) 661-5235
E-mail: info@canforpulp.com
Web: www.canforpulp.com

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

■ OPERATIONS CONTACT INFORMATION

MILLS

Intercontinental Pulp

2533 Prince George Pulp Mill Road
PO Box 6000
Prince George, BC V2N 2K3
Telephone: 250 563-0161
Fax: 250 561-3921

Northwood Pulp

5353 Northwood Pulp Mill Road
PO Box 9000
Prince George, BC V2L 4W2
Telephone: 250 962-3600
Fax: 250 962-3602

Prince George Pulp and Paper

2789 Prince George Pulp Mill Road
PO Box 6000
Prince George, BC V2N 2K3
Telephone: 250 563-0161
Fax: 250 561-3627

OFFICES

Canfor Pulp and Paper

1700 West 75th Avenue
Vancouver, B.C. V6P 6G2
Telephone: 604 661-5269
Fax: 604 661-5226

SUBSIDIARIES AFFILIATES

Canfor Pulp and Paper Europe

2, Avenue de la Foresterie
B-1170 Brussels, Belgium
Telephone: 32 2 674-7950
Fax: 32 2 672-3792

Tokyo, Japan

Arco Tower 16F,
1-8-1 Shimo-Meguro-ku,
Tokyo 153-0064, Japan
Telephone: 03 5434-5778
Fax: 03 5434-5788

Canfor Pulp Income Fund



1700 West 75th Ave
Vancouver, BC
T: 604.661.5241
www.canforpulp.com