CANFOR PULP INCOME FUND

CANFOR PULP LIMITED PARTNERSHIP

Consolidated Financial Statements

For the years ended December 31, 2010 and 2009

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. (CPHI), the general partner of Canfor Pulp Limited Partnership and by the Board of Directors of Canfor Pulp Products Inc. (CPPI). 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.

Management is responsible for designing and maintaining adequate systems of internal controls over financial reporting, including policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of the assets, for the Fund, CPPI and the Partnership. The Partnership's chief executive officer and chief financial officer have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2010, and have concluded that they are operating effectively.

Canadian Forest Products Ltd. (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 Committees.

The Board of Directors of CPHI and CPPI 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 Boards of CPHI and CPPI carry out these activities primarily through the Audit Committees of CPHI and CPPI.

The respective Audit Committees are comprised of independent Directors who are not employees of the Partnership. The Committees meet 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 Committees.

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

(signed) Joe Nemeth

Joe Nemeth
President and CEO
Canfor Pulp Holding Inc.

(signed) Terry Hodgins

Terry Hodgins
Chief Financial Officer and Secretary
Canfor Pulp Holding Inc.

Independent Auditor's Report

To the Shareholders of Canfor Pulp Products Inc.

We have audited the accompanying consolidated financial statements of Canfor Pulp Income Fund (the "Fund") and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of income, comprehensive income, accumulated earnings and distributions, and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Fund and its subsidiaries as at December 31, 2010 and December 31, 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
February 8, 2011
Vancouver, BC

Canfor Pulp Income Fund
Consolidated Statements of Income, Comprehensive Income and Accumulated Earnings and Distributions

(thousands of dollars, except unit and per unit amounts)		**Year ended December 31, 2010**		Year ended December 31, 2009
Income				
Equity income in Canfor Pulp Limited Partnership	**$**	**88,643**	$	6,644
Net income before future income tax recovery		**88,643**		6,644
Future income tax recovery (note 6)		**(1,848)**		(2,422)
Net income		**90,491**		9,066
Distributions declared (note 4)		**(91,573)**		(9,229)
Distributions in excess of earnings	**$**	**(1,082)**	$	(163)
Weighted average number of Fund units		**35,493,307**		35,493,307
Net income per Fund unit, basic and diluted	**$**	**2.55**	$	0.26
Net income for the year	**$**	**90,491**	$	9,066
Equity interest in other comprehensive income (loss) of Canfor Pulp Limited Partnership		**26**		(45)
Comprehensive income	**$**	**90,517**	$	9,021
Accumulated earnings and distributions				
Balance, beginning of year – distributions in excess of earnings	**$**	**(73,026)**	$	**(72,863)**
Distributions in excess of earnings – current year		**(1,082)**		**(163)**
Balance, end of year – accumulated distributions in excess of earnings	**$**	**(74,108)**	$	**(73,026)**

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

Canfor Pulp Income Fund
Consolidated Statements of Cash Flows

(thousands of dollars)		**Year ended December 31, 2010**		Year ended December 31, 2009
Cash generated from (used in)				
Operating activities				
Net income	**$**	**90,491**	$	9,066
Items not affecting cash:				
Equity income in Canfor Pulp Limited Partnership		**(88,643)**		(6,644)
Future income tax recovery		**(1,848)**		(2,422)
Distributions received from Canfor Pulp Limited Partnership		**74,891**		7,809
		74,891		7,809
Financing activities				
Distributions paid to unitholders	**$**	**(74,891)**	$	(7,809)
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 Sheets

(thousands of dollars)		As at December 31, 2010		As at December 31, 2009
ASSETS				
Current assets				
Distributions receivable from Canfor Pulp Limited Partnership (notes 4, 5)	**$**	**19,521**	$	2,839
Total current assets		**19,521**		2,839
Equity investment in Canfor Pulp Limited Partnership (note 3)		**260,740**		263,644
	$	**280,261**	$	266,483
LIABILITIES				
Current liabilities				
Distributions payable (note 4)	**$**	**19,521**	$	2,839
Total current liabilities		**19,521**		2,839
Future income taxes (note 6)		**35,439**		37,287
		54,960		40,126
UNITHOLDERS' EQUITY				
Unitholders' equity – 35,493,307 Fund units outstanding		**299,351**		299,351
Accumulated earnings and distributions		**(74,108)**		(73,026)
Accumulated other comprehensive income (note 7)		**58**		32
Total Unitholders' Equity		**225,301**		226,357
	$	**280,261**	$	266,483

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

Subsequent event (note 11)

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

Approved by the Trustees

(signed) Stan Bracken-Horrocks

Stan Bracken-Horrocks
Trustee

(signed) Charles Jago

Charles Jago
Trustee

Canfor Pulp Income Fund

Notes to the Consolidated Financial Statements as at December 31, 2010

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

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

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.

On January 1, 2011 the Fund was converted to a corporation named Canfor Pulp Products Inc. (CPPI). See subsequent event note 11.

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. Significant areas requiring the use of management estimates are the valuation of the Fund's investment in the Partnership relative to its market value and the determination of future income tax.

Net Income per Fund Unit

Basic net income per Fund unit is based on the weighted average number of Fund units outstanding during the year. At December 31, 2010 and December 31, 2009 the Partnership had 35,776,483 Class B Exchangeable Limited Partnership Units outstanding which can be exchanged for Fund Units at the option of the holder Canadian Forest Products Ltd. (Canfor). Any issuance of new Fund units as a result of such an exchange would be accompanied by 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 only has current taxes on any taxable income not allocated to the unitholders. For the years ended December 31, 2010 and December 31, 2009, all taxable income of the Fund was allocated to the unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the unitholders.

Future Income Taxes

Future income tax assets and liabilities are determined based on the difference between the tax basis of the Fund's and Partnership's assets and liabilities and the respective amounts reported in the financial statements. Future tax assets or liabilities are calculated using the substantively enacted tax rates for the periods in which the differences are expected to be settled. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

3. Equity Investment in Canfor Pulp Limited Partnership

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

(thousands of dollars)	**Year ended December 31, 2010**	Year ended December 31, 2009
Balance, beginning of year	**263,644**	266,274
Equity income of the Partnership	**88,643**	6,644
Equity interest in other comprehensive income (loss) of the Partnership	**26**	(45)
Distributions from the Partnership	**(91,573)**	(9,229)
Balance, end of year	**260,740**	263,644

4. Distributions

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

(thousands of dollars, except per unit amounts)

Record Date	**Payable Date**	**Amount per Fund Unit $**	**Amount $**
January 29, 2010	February 15, 2010	0.08	2,840
February 26, 2010	March 15, 2010	0.12	4,259
March 31, 2010	April 15, 2010	0.12	4,259
April 30, 2010	May 14, 2010	0.12	4,259
May 31, 2010	June 15, 2010	0.20	7,099
June 30, 2010	July 15, 2010	0.20	7,099
July 30, 2010	August 13, 2010	0.22	7,809
August 31, 2010	September 15, 2010	0.22	7,809
September 30, 2010	October 15, 2010	0.25	8,873
October 29, 2010	November 15, 2010	0.25	8,873
November 30, 2010	December 15, 2010	0.25	8,873
December 31, 2010	January 14, 2011	0.55	19,521
		2.58	91,573

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

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

5. Related Party Transactions

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf, without charge, by the Partnership pursuant to a support agreement. Distributions earned from the Partnership for the year ended December 31, 2010 were $91.6 million of which $72.1 million was received, with the balance of $19.5 million receivable on December 31, 2010. For the year ended December 31, 2009 distributions earned were $9.2 million of which $6.4 million was received, with the balance of $2.8 million receivable on December 31, 2009.

6. Future Income Taxes

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

(thousands of dollars)	**Year ended December 31, 2010**	Year ended December 31, 2009
Expected income tax expense at statutory tax rate of nil (2009 – nil)	**-**	-
Future income tax recovery on temporary differences	**(1,848)**	(2,422)
	(1,848)	(2,422)

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

(thousands of dollars)	**December 31, 2010**	December 31, 2009
Future income tax liability:		
Equity investment in the Partnership	**35,439**	42,347
Expected reversal of temporary differences prior to 2011	**-**	(5,060)
	35,439	37,287

Based on a current estimate of the income tax liability at the beginning of 2011, the Fund has recorded a future income tax liability and corresponding cumulative non-cash future tax charge to net income. This non-cash charge relates to the Fund's 49.8% ownership in the Partnership and is based on temporary differences between the accounting and tax basis of the Partnership's assets and liabilities expected to reverse after January 1, 2011.

7. Accumulated Other Comprehensive Income

(thousands of dollars)	**Year ended December 31, 2010**	Year ended December 31, 2009
Balance, beginning of year	**32**	77
Other comprehensive income (loss)	**26**	(45)
Balance, end of year	**58**	32

8. Capital Disclosures

The Fund's capital is comprised of unitholders' equity and accumulated earnings and distributions. The Fund's only source of liquidity is distributions received from the Partnership. The Fund's objective when managing capital is to make its own distributions to unitholders based on the distributions received from the Partnership.

(thousands of dollars)	**December 31, 2010**	December 31, 2009
Unitholders' equity [1]	**225,243**	226,325

Note [1]: Excludes accumulated other comprehensive income.

The Fund has no external capital requirements or covenants.

9. Financial Instruments

The Fund's financial instruments consist of distributions receivable from the Partnership and distributions payable to unitholders. Distributions receivable are classified as loans and receivables, and are measured at amortized cost. Distributions payable are classified as other liabilities and are measured at amortized cost. The carrying values of these financial instruments approximate their fair values due to the relatively short period to maturity of these instruments.

Financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The Fund is not required to disclose fair value hierarchy levels for distributions receivable from the Partnership and distributions payable to unitholders, as the fair values of these financial instruments approximate the carrying value due to their short–term nature.

The Fund is exposed to certain risks related to the nature of its investment in the Partnership and the structure of the Fund, as well as the underlying risks related to the business of the Partnership. The Fund relies on the objectives, policies and processes of the Partnership for managing these risks.

10. Segmented Information

The Fund operates in one industry segment, namely investing in pulp and paper producing assets in one geographic region, Canada.

11. Subsequent Event

The conversion of the Fund into a dividend paying public taxable Canadian corporation named Canfor Pulp Products Inc. has been completed effective January 1, 2011 under the previously announced plan of arrangement approved by unitholders in April 2010. Under the arrangement, unitholders of the Fund received, for each unit of the Fund held, one common share of CPPI. The conversion was completed on a tax-free rollover basis in accordance with the legislation enacted on March 12, 2009 by the Canadian government (SIFT Conversion Rules). The reorganization was completed with the winding up of the Fund and Trust.

Independent Auditor's Report

To the Partners of Canfor Pulp Limited Partnership

We have audited the accompanying consolidated financial statements of Canfor Pulp Limited Partnership (the "Partnership") and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of income, comprehensive income and Partners' equity and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Partnership and its subsidiaries as at December 31, 2010 and December 31, 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
February 8, 2011
Vancouver, BC

Canfor Pulp Limited Partnership
Consolidated Statements of Income, Comprehensive Income and Partners' Equity

(millions of dollars, except units and per unit amounts)		**Year ended December 31, 2010**		Year ended December 31, 2009
Revenue				
Sales	**$**	**1,001.1**	$	813.5
Business interruption insurance		**-**		3.2
		1,001.1		816.7
Costs and expenses				
Manufacturing and product costs		**622.0**		611.2
Freight and other distribution costs		**122.7**		121.1
Amortization		**47.4**		49.4
Selling and administration costs		**26.3**		23.0
		818.4		804.7
Operating income		**182.7**		12.0
Interest expense, net		**(7.8)**		(10.1)
Foreign exchange gain on long-term debt		**5.7**		19.6
Gain (loss) on derivative financial instruments (note 13)		**1.5**		(1.5)
Foreign exchange loss on working capital		**(4.0)**		(6.7)
Other income (expense)		**(0.1)**		0.1
		(4.7)		1.4
Net income		**178.0**		13.4
Other comprehensive income (note 16)		**0.1**		(0.1)
Comprehensive income	**$**	**178.1**	$	13.3
Net income per Partnership unit (note 12)				
Basic and diluted	**$**	**2.50**	$	0.19
Weighted average Partnership units outstanding		**71,270,025**		71,270,025
Partners' Equity				
Balance, beginning of year	**$**	**529.1**	$	534.4
Net income		**178.0**		13.4
Distributions declared to partners (note 15)		**(183.9)**		(18.6)
Other comprehensive income (loss) (note 16)		**0.1**		(0.1)
Balance, end of year	**$**	**523.3**	$	529.1

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

Canfor Pulp Limited Partnership
Consolidated Statements of Cash Flows

(millions of dollars)	**Year ended December 31, 2010**	Year ended December 31, 2009
Cash and cash equivalents generated from (used in)		
Operating activities		
Net income	**$ 178.0**	$ 13.4
Items not affecting cash:		
Amortization	**47.4**	49.4
Foreign exchange gain on long-term debt	**(5.7)**	(19.6)
Increase in value of outstanding derivative instruments	**(1.0)**	(2.1)
Employee future benefits, net of cash payments	**7.7**	5.2
Change in deferred maintenance provision	**8.4**	5.9
Other	**(0.2)**	0.4
Salary pension plan contribution	**(6.5)**	(2.5)
Long-term deferred maintenance expenditure	**(6.1)**	(10.5)
Other deferred expenditure	**-**	(0.2)
Cash flow from operations before working capital changes	**222.0**	39.4
Decrease (increase) in non-cash working capital (note 14)	**(2.4)**	31.8
	219.6	71.2
Financing activities		
Distributions paid to partners	**(150.4)**	(15.7)
Operating loan repayment (note 8)	**-**	(25.2)
	(150.4)	(40.9)
Investing activities		
Property, plant and equipment, net (note 14)	**(38.7)**	(17.3)
Green Transformation program reimbursements	**20.2**	-
Insurance proceeds	**-**	0.1
	(18.5)	(17.2)
Increase in cash and cash equivalents	**50.7**	13.1
Cash and cash equivalents, beginning of year	**13.5**	0.4
Cash and cash equivalents, end of year	**$ 64.2**	$ 13.5

Supplementary cash flow information (note 14).

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

Canfor Pulp Limited Partnership
Consolidated Balance Sheets

(millions of dollars)	As at December 31, 2010	As at December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	**$ 64.2**	$ 13.5
Accounts receivable (notes 11, 18)		
Trade	**108.0**	110.5
Green Transformation Program	**17.9**	-
Other	**14.8**	8.6
Inventories (note 3)	**123.4**	135.4
Prepaid expenses and other assets	**21.8**	18.4
Total current assets	**350.1**	286.4
Property, plant and equipment (notes 4 and 18)	**499.6**	534.1
Other long-term assets (note 5)	**17.6**	17.1
	$ 867.3	$ 837.6
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 11)	**139.3**	134.5
Distributions payable (note 15)	**39.2**	5.7
Total current liabilities	**178.5**	140.2
Long-term debt (note 8)	**109.4**	115.1
Long-term liabilities (note 9)	**56.1**	53.2
	$ 344.0	$ 308.5
PARTNERS' EQUITY – 14,254,005 Class A Limited Partnership Units and 57,016,020 Class B Limited Partnership Units (note 1)	**523.3**	529.1
	$ 867.3	$ 837.6

Commitments and contingencies (note 17).

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.

(signed) Stan Bracken-Horrocks	*(signed) Joe Nemeth*
Stan Bracken-Horrocks	Joe Nemeth
Director	Director

Canfor Pulp Limited Partnership

Notes to the Consolidated Financial Statements as at December 31, 2010 and 2009

1. Business Description and Basis of Presentation of Financial Statements

Canfor Pulp Limited Partnership (the Partnership) is a limited partnership formed on April 21, 2006, under the laws of Manitoba, to acquire and carry on the NBSK pulp and paper business of Canadian Forest Products Ltd. a subsidiary of Canfor Corporation (collectively Canfor). The business consists of two NBSK pulp mills and one NBSK pulp and paper mill located in Prince George, British Columbia and a marketing group based in Vancouver, British Columbia (the Pulp Business).

At December 31, 2010, Canfor owned 50.2% and Canfor Pulp Income Fund (the Fund) indirectly owned 49.8% of the issued and outstanding units of the Partnership.

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

These audited consolidated financial statements are those of the Partnership and do not include the assets, liabilities, revenues and expenses of its partners. The Partnership, other than its incorporated subsidiaries, is not subject to income taxes as its income is allocated for tax purposes to its partners. Accordingly, no recognition has been made for income taxes related to Partnership income in these financial statements. The tax attributes of the Partnership's net assets flow directly to the partners.

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

Economic Dependence

The Partnership depends on Canfor to provide approximately 56% (2009 – 63%) of its fibre supply as well as to provide certain key business and administrative services as described in note 11. As a result of these relationships the Partnership considers its operations to be dependent on its ongoing relationship with Canfor.

2. Significant Accounting Policies

Principles of Consolidation

These audited consolidated financial statements include the accounts of the Partnership, its wholly owned subsidiaries and its 50% interest in Premium One Papers (a general partnership). The 50% interest in the general partnership is 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, asset retirement obligations, impairment of long-lived assets, provisions for insurance claims and environmental remediation.

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, wood chips, and processing materials and supplies are valued at the lower of average cost and net realizable value.

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.

Government Assistance

Government assistance relating to the acquisition of property, plant and equipment is recorded as a reduction of the cost of the related asset with any amortization calculated on the net amount. Government assistance related to current expenses is recorded as a reduction of the related expenses.

Employee Future Benefits

The Partnership provides certain pension, health care benefits and pension bridge plans to eligible retired employees.

The Partnership accrues the costs and related obligations of the defined benefit salary pension plans, the pension bridge plan and other retirement benefit plans using the projected benefit actuarial method prorated on service and management's best estimates of salary escalation and other relevant factors. Actuarial gains and 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 10 years for the salary pension plan, 11 years for the pension bridge plan and 11 years for the other benefit plans. Pension plan assets are valued at fair value for purposes of calculating the expected return on plan assets. 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.

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, sales commissions and energy. 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 collectability 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 Partnership 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 sales contracts to hedge related foreign currency denominated accounts receivable balances and also enters into swap transactions to reduce its exposure to fluctuating natural gas prices. The Partnership records all derivatives at fair value and its policy is not to utilize derivative financial instruments for trading or speculative purposes.

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 over their estimated remaining useful lives. 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.

Major Maintenance Costs

The Partnership has 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 Partnership has presented the related unamortized expenditures in prepaid expense and other assets, and other long-term assets, as appropriate.

3. Inventories

(millions of dollars)	**December 31, 2010**	December 31, 2009
Pulp	**52.7**	55.2
Paper	**10.1**	15.9
Wood chips	**16.4**	21.5
Processing materials and supplies	**44.2**	42.8
	123.4	135.4

4. Property, Plant and Equipment

	December 31, 2010		
(millions of dollars)	**Cost**	**Accumulated amortization**	**Net**
Land and improvements	**5.4**	**-**	**5.4**
Asset retirement - landfill	**2.3**	**0.9**	**1.4**
Buildings, machinery and equipment	**1,356.1**	**867.0**	**489.1**
Construction in progress	**3.7**	**-**	**3.7**
	1,367.5	**867.9**	**499.6**

	December 31, 2009		
(millions of dollars)	Cost	Accumulated amortization	Net
Land and improvements	5.4	-	5.4
Asset retirement - landfill	2.3	0.8	1.5
Buildings, machinery and equipment	1,344.1	820.1	524.0
Construction in progress	3.2	-	3.2
	1,355.0	820.9	534.1

5. Other Long-term Assets

(millions of dollars)	**December 31, 2010**	December 31, 2009
Pension benefit plan (note 6)	**14.0**	11.3
Maintenance shutdown costs	**3.1**	5.4
Other	**0.5**	0.4
	17.6	17.1

6. Employee Future Benefits

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

Total employee future benefit expenses were as follows:

	Year ended December 31	
(millions of dollars)	**2010**	2009
Pension plans	**6.0**	5.0
Other employee future benefit plans	**4.4**	3.5
Contributions to forest industry union plans	**6.4**	6.5
	16.8	15.0

Defined benefit plans

The measurement date for the determination of accrued benefit obligations and the fair value of plan assets for the employee future benefit plans is September 30, 2010. The most recent actuarial valuation for funding purposes for the Canfor salaried employees' pension plans in which the Partnership's employees participate was effective as of December 31, 2009. The most recent actuarial valuations for the other post retirement benefit plan and the Pension Bridge Plan were on September 30, 2007 and December 31, 2006, respectively.

Information about the Partnership's defined benefit plans, including its identified participation in the Canfor salaried employee pension plans and other post-employment benefit plans and the Pension Bridge Plan, are as follows:

Defined Benefit Plan Assets

	2010		2009	
(millions of dollars)	**Pension Benefit Plans**	**Other Benefit Plans**	Pension Benefit Plans	Other Benefit Plans
Fair market value of plan assets				
Beginning of year	**$ 52.7**	**$ -**	$ 51.0	$ -
Actual return on plan assets	**5.0**	**-**	0.1	-
Employer contributions	**4.2**	**1.2**	3.0	1.0
Employee contributions	**0.3**	**-**	0.3	-
Benefit payments	**(3.0)**	**(1.2)**	(1.7)	(1.0)
End of year	**$ 59.2**	**$ -**	$ 52.7	$ -

	Percentage of Plan Assets	
	2010	2009
Plan assets consist of the following:		
Equity securities	**68%**	58%
Debt securities	**32%**	41%
Other	**-**	1%
	100%	100%

Defined Benefit Plan Obligations

(millions of dollars)	**2010** Pension Benefit Plans	**2010** Other Benefit Plans	2009 Pension Benefit Plans	2009 Other Benefit Plans
Accrued benefit obligation				
Beginning of year	**$ 68.4**	**$ 44.3**	$ 60.5	$ 37.1
Current service cost	**3.7**	**0.8**	2.9	0.7
Interest cost	**4.3**	**3.0**	4.0	2.5
Employee contributions	**0.3**	**-**	0.3	-
Benefit payments	**(3.0)**	**(1.2)**	(1.7)	(1.0)
Actuarial loss	**13.1**	**11.0**	2.4	5.0
End of year	**$ 86.8**	**$ 57.9**	$ 68.4	$ 44.3

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

(millions of dollars)	**2010** Pension Benefit Plans	**2010** Other Benefit Plans	2009 Pension Benefit Plans	2009 Other Benefit Plans
Fair market value of plan assets	**$ 59.2**	**$ -**	$ 52.7	$ -
Accrued benefit obligation	**(86.8)**	**(57.9)**	(68.4)	(44.3)
Funded status of plans – deficit	**(27.6)**	**(57.9)**	(15.7)	(44.3)
Employer contributions after measurement date	**4.7**	**0.3**	0.8	0.3
Unamortized transitional obligation (asset)	**(0.7)**	**4.0**	(0.8)	4.7
Unamortized past service costs	**2.1**	**-**	2.2	-
Unamortized net actuarial loss (gain)	**28.9**	**7.4**	18.2	(3.9)
Accrued benefit asset (liability)	**$ 7.4**	**$ (46.2)**	$ 4.7	$ (43.2)
The accrued benefit asset (liability) is included in the Partnership's balance sheet as follows:				
Other long-term assets (note 5)	**$ 14.0**	**$ -**	$ 11.3	$ -
Accounts payable and accrued liabilties	**-**	**-**	(0.8)	-
Long-term liabilities (note 9)	**(6.6)**	**(46.2)**	(5.8)	(43.2)
	$ 7.4	**$ (46.2)**	$ 4.7	$ (43.2)

Included in the above pension and other retirement benefit provisions and fair value of plan assets at year-end are the following amounts in respect of plans that are not fully funded:

(millions of dollars)	**2010** Pension Benefit Plans	**2010** Other Benefit Plans	2009 Pension Benefit Plans	2009 Other Benefit Plans
Fair market value of plan assets	**$ 59.2**	**$ -**	$ 52.7	$ -
Accrued benefit obligation	**(86.8)**	**(57.9)**	(68.4)	(44.3)
Funded status - plan deficit	**$ (27.6)**	**$ (57.9)**	$ (15.7)	$ (44.3)

Included in the $27.6 million pension plan deficit noted above, is $12.0 million relating to the Pension Bridge Plan and other pension plans, for which no funding obligation is required (2009 – $11.3 million).

The expense for the Partnership sponsored defined benefit plans are as follows:

(millions of dollars)	**2010** Incurred in Year	**2010** Matching Adjustments[1]	**2010** Recognized in Year	2009 Incurred in Year	2009 Matching Adjustments[1]	2009 Recognized in Year
Defined Benefit Pension Plans						
Current service cost, net of employee contributions	**$ 3.7**	**$ -**	**$ 3.7**	$ 2.9	$ -	$ 2.9
Interest cost	**4.3**	**-**	**4.3**	4.0	-	4.0
Return on plan assets	**(5.0)**	**0.9**	**(4.1)**	(0.1)	(3.8)	(3.9)
Actuarial loss (gain)	**13.1**	**(11.6)**	**1.5**	2.4	(1.4)	1.0
Plan amendments	**-**	**0.1**	**0.1**	-	0.2	0.2
Amortization of transitional obligation	**-**	**-**	**-**	-	(0.1)	(0.1)
	$ 16.1	**$ (10.6)**	**$ 5.5**	$ 9.2	$ (5.1)	$ 4.1
Other Benefit Plans						
Current service cost, net of employee contributions	**$ 0.8**	**$ -**	**$ 0.8**	$ 0.7	$ -	$ 0.7
Interest cost	**3.0**	**-**	**3.0**	2.5	-	2.5
Actuarial loss (gain)	**11.0**	**(11.2)**	**(0.2)**	5.0	(5.6)	(0.6)
Amortization of transitional obligation	**-**	**0.8**	**0.8**	-	0.8	0.8
	$ 14.8	**$ (10.4)**	**$ 4.4**	$ 8.2	$ (4.8)	$ 3.4

[1] Accounting adjustments to allocate costs to different periods so as to recognize the long-term nature of employee future benefits.

Significant Assumptions

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

(weighted average assumptions)	**2010** Pension Benefit Plans	**2010** Other Benefit Plans	2009 Pension Benefit Plans	2009 Other Benefit Plans
Accrued benefit obligation as of December 31:				
Discount rate	**5.25%**	**5.5%**	6.25 %	6.75 %
Rate of compensation increase	**3.0%**	**n/a**	3.0 %	n/a
Benefit costs for year ended December 31:				
Discount rate	**6.25%**	**6.75%**	6.60 %	6.7 %
Expected long-term rate of return on plan assets	**7.5%**	**n/a**	7.5 %	n/a
Rate of compensation increase	**3.0%**	**n/a**	3.0 %	n/a

Assumed health care cost trend rates (weighted average assumptions)	**2010**	2009
Initial health care cost trend rate	**7.16%**	7.40%
Ultimate health care trend rate	**4.10%**	4.10%
Year ultimate rate is reached	**2029**	2029

Sensitivity analysis

Assumed health care cost trend rates have a significant effect on the amounts reported for the other benefit plans. A one percentage point change in assumed health care cost trend rates would have the following effects for 2010:

		1% Increase		1% Decrease
Accrued benefit obligation	**$**	**10.7**	**$**	**(8.6)**
Total of service and interest cost		**0.8**		**(0.5)**

7. Asset Retirement Obligations

(millions of dollars)	**December 31, 2010**	December 31, 2009
Balance beginning of year	**3.0**	2.8
Accretion expense	**0.1**	0.2
Balance end of year	**3.1**	3.0

The Partnership's asset retirement obligations represent estimated undiscounted future payments of $40.6 million to remediate the landfills at the end of their useful lives. Payments relating to landfill closure costs are expected to occur at periods ranging from 32 to 40 years which have been discounted at 5.8% and 6.3%, respectively. The estimated fair value is $3.1 million and the amount is included in long-term liabilities.

The Partnership has certain assets that have indeterminate useful lives and, therefore, there is an indeterminate settlement date for the related asset retirement obligation. As a result, no asset retirement obligations were recorded for these assets. These assets include, for example, wastewater and effluent ponds that will have to be drained once the related operating facility is closed and storage sites for which removal of chemicals and other related materials will be required once the related operating facility is closed. Once the useful life of these assets becomes determinable and an estimate of fair value can be made, an asset retirement obligation will be recorded.

8. Credit Facilities and Long-term Debt

At December 31, 2010 the Partnership has outstanding long-term debt of $109.4 million (2009 – $115.1 million, US$110.0 million for both 2010 and 2009) in the form of unsecured US dollar private placement notes (the Notes). The Notes bear interest at 6.41% and are repayable in full on their maturity date of November 30, 2013.

The Partnership has a $40 million bank credit facility with a maturity date of November 30, 2011, of which $0.5 million was utilized at December 31, 2010 for a standby letter of credit issued for general business purposes. In addition, the Partnership has arranged a separate facility with a maturity date of November 30, 2011, to cover the $13.2 million standby letter of credit issued to BC Hydro under the Energy Purchase Agreement. Interest and other costs of the bank credit facility are at prevailing market rates.

The Notes and bank credit agreements each contain similar financial covenants including a maximum allowable debt:EBITDA leverage ratio and minimum required EBITDA:interest coverage ratio. The Partnership remained in compliance with all covenants at December 31, 2010 and throughout the year.

The fair value of long-term debt at December 31, 2010 was $117.8 million (US$118.4 million).

9. Long-term Liabilities

(millions of dollars)	**December 31, 2010**	December 31, 2009
Pension obligations under defined benefit plans (note 6)	**6.6**	5.8
Post employment benefits (note 6)	**46.2**	43.2
Other pension obligations	**0.2**	-
Derivative financial instruments (note 13)	**-**	1.2
Asset retirement obligations (note 7)	**3.1**	3.0
	56.1	53.2

10. Capital Disclosures

The Partnership's objectives when managing capital are to safeguard its assets and maintain a globally competitive cost structure, continue as a going concern and provide returns to its partners in the form of distributions and capital appreciation. In addition, the Partnership works with relevant stakeholders to ensure the safety of its operations and employees, and to remain in compliance with all environmental regulations.

The Partnership's capital is comprised of net debt and Partners' equity:

(millions of dollars)	**December 31, 2010**	December 31, 2009
Total debt	**109.4**	115.1
Cash and cash equivalents	**(64.2)**	(13.5)
Net debt	**45.2**	101.6
Total Partners' equity[1]	**523.2**	529.1
	568.4	630.7

Note: [1] Excludes accumulated other comprehensive income – note 16.

Management determines the level of cash distributions based on the level of cash flow from operations before changes in non-cash working capital and long-term deferred maintenance, less actual capital expenditures (net of Green Transformation Program reimbursements). During the year distributions are based on estimates of full year cash flow and capital spending; thus distributions may be adjusted as these estimates change. It is expected that normal seasonal fluctuations in non-cash working capital will be funded from cash resources or the revolving short-term credit facility, and thus will not significantly affect the level of distributions.

The Partnership's long-term debt and short-term credit facility agreements contain leverage and interest ratio covenants, as described in note 8.

11. Related Party Transactions

The Partnership purchased wood chips and hog fuel from Canfor sawmills in the amount of $126.2 million in 2010 (2009 – $119.4 million). The Partnership also purchased wood chips from Lakeland Mills Ltd., in which Canfor owns a one-third interest in the amount of $6.1 million in 2010 (2009 – $3.9 million). Purchased wood chips and hog fuel are included in manufacturing and product costs.

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 2010 was $3.0 million (2009 – $3.0 million), included in manufacturing and product costs and selling and administration costs.

Effective July 1, 2006, the Partnership entered into an incidental services agreement with Canfor, under which the Partnership provides certain business and administrative services to Canfor. Total value of the services provided in 2010 was $1.7 million (2009 – $1.7 million), included in manufacturing and product costs and selling and administration costs.

The Partnership markets bleached chemi-thermo mechanical pulp production from Canfor's Taylor Pulp Mill (Taylor) for which it earned commissions totaling $1.7 million in 2010 (2009 – $1.9 million), included in sales. The Partnership also purchased chemi-thermo mechanical pulp from Taylor for resale totaling $1.5 million in 2010 (2009 – $1.7 million). The Partnership sold NBSK pulp to Taylor for packaging use totaling $3.0 million in 2010 (2009 – $2.3 million). In respect of the products marketed and services provided for Taylor, the Partnership held balances of $22.2 million in accounts receivable - trade (2009 – $24.4 million) and $23.6 million in accounts payable (2009 – $24.5 million) to Canfor at December 31, 2010.

In October of 2010, Canfor sold its 50% ownership of Howe Sound Pulp and Paper Limited Partnership (HSLP). Until this time, the Partnership marketed the NBSK pulp produced by HSLP, for which it earned commissions totaling $1.8 million in 2010 (2009 – $2.4 million), included in sales. In respect of the products marketed and service provided for HSLP, the Partnership held balances of $1.0 million in accounts receivable - trade (2009 – $16.5 million) and $8.9 million in accounts payable (2009 – $17.6 million) to Canfor at December 31, 2010. As a result of the sale of HSLP by Canfor, the Partnership's agreement to market HSLP pulp was terminated by the buyer and as compensation the Partnership received a contract termination fee of $1.3 million from HSLP, included in selling and administration costs.

Under the agreements for the marketing of production from Taylor, the Partnership assumes the customer credit risk. Accordingly, the Partnership records on its balance sheet the accounts receivable from the customer and the accounts payable to Canfor for sales made under those agreements.

At December 31, 2010, a total of $12.0 million (2009 – $16.3 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, 2010 a total of $0.4 million (2009 – $0.4 million) was payable to Lakeland Mills Ltd. for wood chips.

During 2010, the Partnership declared distributions totaling $183.9 million to its limited partners. Distributions to Canfor were $92.3 million, of which $72.6 million was paid, with the balance of $19.7 million recorded in accounts payable as at December 31, 2010. Distributions to the Fund were $91.6 million, of which $72.1 million was paid, with the balance of $19.5 million recorded in accounts payable as at December 31, 2010. For the year ended December 31, 2009, the Partnership declared distributions totaling $18.6 million to its limited partners. Distributions to Canfor were $9.4 million, of which $6.5 million was paid, with the balance of $2.9 million recorded in accounts payable as at December 31, 2009. Distributions to the Fund were $9.2 million, of which $6.4 million was paid, with the balance of $2.8 million recorded in accounts payable as at December 31, 2009.

These transactions occurred in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

12. Net Income per Partnership Unit

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

13. Financial Instruments

Classification of Financial Instruments

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

Financial Risk Management

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

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

I. *Credit risk:*

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

In order to mitigate the risk of financial loss, cash on deposit is held with major Canadian and international financial institutions. The cash and cash equivalents balance at December 31, 2010 was $64.2 million. The Partnership does not believe there is any significant credit risk associated with cash on deposit held in major Canadian and international financial institutions.

The Partnership utilizes a combination of credit insurance and self-insurance to manage the risk associated with trade receivables. Approximately 87% of the outstanding trade receivables are covered under credit insurance. In addition, the Partnership requires letters of credit on certain export trade receivables and periodically discounts these letters of credit without recourse. The Partnership recognizes the sale of the letters of credit on the settlement date, and accordingly reduces the related trade accounts receivable balance. At December 31, 2010, the Partnership had reduced the trade accounts receivable balance by $39.0 million due to discounting of letters of credit. The Partnership's trade receivable balance at December 31, 2010 was $108.0 million. The Partnership believes that its approach to managing credit risk associated with the collection of outstanding trade accounts receivable is appropriate in the current credit market.

II. *Liquidity risk:*

Liquidity risk is the risk that the Partnership will be unable to meet its financial obligations as they fall due. The Partnership manages liquidity risk through management of its capital structure in conjunction with cash flow forecasting including anticipated investing and financing activities, and use of the bank credit facility to meet short-term working capital requirements.

The Partnership also reviews on an ongoing basis, the level of distributions, capital expenditures and timing of scheduled major maintenance outages and may adjust these amounts periodically to manage cash resources. In addition, the Partnership periodically utilizes discounting of letters of credit on outstanding trade receivables to manage liquidity risk. At December 31, 2010, the impact of discounting of letters of credit accelerated cash collection and reduced the trade accounts receivable balance by $39.0 million. The Partnership believes it will be able to meet all of its financial obligations as they become due.

At December 31, 2010, the Partnership's accounts payable and accrued liabilities totaled $139.3 million, all of which fall due for payment within one year of the balance sheet date. The Partnership's distributions payable at December 31, 2010 totaled $39.2 million, which are payable on January 14, 2011.

III. *Market risk:*

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

a. Interest rate risk:

The Partnership is exposed to interest rate risk through its financial assets and financial obligations bearing variable interest rates and through its off-balance sheet lease obligations.

The Partnership manages interest rate risk by maximizing the interest earned on excess funds while maintaining the liquidity necessary to meet day-to-day operating cash flow requirements and payment of monthly declared distributions to unitholders.

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

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

b. Currency risk:

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

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

c. Commodity price risk:

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

The Partnership may periodically use derivative instruments to mitigate commodity price risk. For the year ended December 31, 2010 the Partnership used derivative instruments to reduce exposure to natural gas prices.

In addition, the sensitivity of the 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	$ 6
NBSK pulp – US $10 change per tonne	7
Natural gas cost - $1 change per gigajoule	4
Chip cost - $2 change per tonne	5

Fair Value Hierarchy

Financial instruments recognized at fair value on the Consolidated Balance Sheet must be classified in one of the following three fair value hierarchy levels:

- Level 1 – measurement based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities;
- Level 2 – measurement based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability;
- Level 3 – measurement based on inputs that are not observable (supported by little or no market activity) for the asset or liability.

The following table sets forth the carrying value and the fair value of the Partnership's financial assets and liabilities. The table also identifies the levels per the fair value hierarchy where fair value is recognized in the balance sheet.

As at December 31, 2010

(millions of dollars)	Carrying Value	Fair Value	Fair Value Hierarchy Level
Financial assets:			
Cash and cash equivalents[1]	64.2	64.2	1
Accounts receivable[1]	139.6	139.6	2
Derivative assets[2]	1.1	1.1	2
Financial liabilities:			
Account payable and accrued liabilities[1]	136.8	136.8	2
Distributions payable[1]	39.2	39.2	2
Long-term debt[3]	109.4	117.8	N/A
Derivative liabilities[2]	2.5	2.5	2

1 Fair value approximates carrying value due to the short term nature of these instruments.
2 The fair value of derivative instruments is based on quoted market prices for comparable contracts and represents the amount the Partnership would have received from, or paid to, a counterparty to unwind the contract at the market rates in effect at the balance sheet dates and therefore derivative instruments are classified within Level 2 of the fair value hierarchy established by section 3862. Derivative assets are recorded in other accounts receivable and derivative liabilities are recorded in accounts payable and accrued liabilities in the consolidated balance sheet.
3 Recorded at amortized cost.

Derivative Instruments

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

For the year ended December 31, 2010 the Partnership recorded a net gain on derivative financial instruments of $1.5 million (2009 – net loss of $1.5 million) relating to settlement of maturing contracts during the year and the revaluation to market of outstanding contracts at the end of the year, for natural gas swaps and US dollar forward contracts.

For the year ended December 31, 2010 the Partnership recorded losses of $3.7 million (2009 – $7.6 million) relating to settlement of maturing natural gas swaps as a charge to non-operating income. At December 31, 2010 the Partnership had outstanding commodity swaps hedging future natural gas purchases of 0.6 million gigajoules extending to October, 2011. At December 31, 2010 the unrealized loss of $2.5 million (2009 – $3.5 million) on these outstanding commodity swaps is recorded as a liability in accounts payable and accrued liabilities.

For the year ended December 31, 2010 the Partnership recorded a net gain of $4.2 million (2009 – $4.0 million) on settlement of maturing US dollar forward contracts as a credit to non-operating income. At December 31, 2010 the Partnership had outstanding US dollar forward contracts of $60.0 million extending to April, 2011. At December 31, 2010 the unrealized gain of $1.1 million (2009 – $1.1 million) on these outstanding US dollar forward contracts is recorded as an asset in other accounts receivable.

14. Supplementary Cash Flow Information

	Year ended December 31	
(millions of dollars)	**2010**	2009
Decrease (increase) in non-cash working capital		
Accounts receivable – trade and other	**(3.5)**	(33.4)
Insurance receivable	**-**	7.3
Inventories	**11.9**	41.3
Prepaid expenses and other assets	**(3.4)**	(1.8)
Accounts payable and accrued liabilities	**(7.4)**	18.4
	(2.4)	31.8
Capital expenditures		
Capital expenditures - cash	**38.7**	17.3
Less amount reimbursable – Green Transformation Program	**(26.7)**	-
	12.0	17.3
Proceeds on disposal of fixed assets	**0.5**	-
Capital expenditures accruals – net	**0.6**	(3.8)
	13.1	13.5
Net interest paid	**7.5**	9.0

15. Distributions

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

(millions of dollars, except per unit amounts) **Record Date**	**Payable Date**	**Amount per Partnership Unit $**	**Amount $**
January 29, 2010	February 15, 2010	0.08	**5.7**
February 26, 2010	March 15, 2010	0.12	**8.5**
March 31, 2010	April 15, 2010	0.12	**8.6**
April 30, 2010	May 14, 2010	0.12	**8.6**
May 31, 2010	June 15, 2010	0.20	**14.2**
June 30, 2010	July 15, 2010	0.20	**14.3**
July 30, 2010	August 13, 2010	0.22	**15.7**
August 31, 2010	September 15, 2010	0.22	**15.7**
September 30, 2010	October 15, 2010	0.25	**17.8**
October 29, 2010	November 15, 2010	0.25	**17.8**
November 30, 2010	December 15, 2010	0.25	**17.8**
December 31, 2010	January 14, 2011	0.55	**39.2**
		2.58	**183.9**

16. Accumulated Other Comprehensive Income

(millions of dollars)	Year ended December 31, 2010	Year ended December 31, 2009
Balance, beginning of year	**-**	0.1
Adjustment for exchange translation	**0.1**	(0.2)
Adjustment for derivatives recorded in other comprehensive income (loss)	**-**	0.1
Balance, end of year	**0.1**	-

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

(millions of dollars)	December 31, 2010
Cumulative comprehensive income	**454.8**
Cumulative distributions	**(519.0)**
	(64.2)
Partners' capital – at July 1, 2006	**587.5**
Partners' equity, end of year	**523.3**

17. Commitments and Contingencies

The Partnership has committed to the following operating leases for property, plant and equipment. As at December 31, 2010, the future minimum lease payments under these operating leases were as follows:

(millions of dollars)	
2011	2.4
2012	1.6
2013	0.8
Thereafter	1.1
Total minimum lease payments	5.9

The Partnership's Energy agreement with BC Hydro provides for the sale of power production that exceeds an amended commitment of the original cogeneration project at the Prince George Pulp and Paper Mill. The obligation to produce power for the remainder of the term of the agreement, extending to August 2020, is reduced to 338 GWh per year from 390 GWh effective September 15, 2009. Under the amended Cogeneration Agreement with BC Hydro, if the cogeneration project generates less than the amended commitment in any year and the shortfall cannot be made up by excess generation in prior years or excess generation in the subsequent year, the Partnership is required to pay BC Hydro an amount equal to the uncorrected shortfall as a ratio of the annual requirement. 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, 2010, the Partnership has no repayment obligation under the terms of the agreement and a standby letter of credit in the amount of $13.2 million has been issued to BC Hydro.

Significant contractual commitments relating to the construction of capital assets totaled $6.5 million at December 31, 2010 (2009 – nil). These commitments related to projects funded under the Canadian Federal government's Green Transformation Program.

18. Pulp and Paper Green Transformation Program

On October 9, 2009 the Canadian Federal government announced the allocation of credits from the billion dollar Pulp and Paper Green Transformation Program (the Program). The Partnership has been allocated $122.2 million from the Program announced by the Canadian government on June 17, 2009. The Program is designed as a reimbursement of funds to be spent on qualifying energy and environmental capital projects. Credits may be used until the program end date of March 31, 2012. The Partnership has received Program approval to proceed with three projects totaling $115.6 million. The Partnership expects to submit further projects over the balance of 2011. As of December 31, 2010 the Partnership has incurred $38.1 million and received reimbursements totaling $20.2 million with the balance of $17.9 million receivable on December 31, 2010**.** The Partnership submits claims for expenditures on approved projects under the Program on a monthly basis. These projects are expected to provide economic and environmental benefits to the Partnership's operations.

19. Segmented Information [(a)]

(millions of dollars)	Pulp	Paper	Unallocated Costs	Total
Year ended December 31, 2010				
Sales to external customers [(b)]	**857.2**	**142.6**	**1.3**	**1,001.1**
Sales of pulp to paper segment [(c)]	**89.6**	**(89.6)**	**-**	**-**
Operating income (loss)	**198.1**	**0.5**	**(15.9)**	**182.7**
Amortization	**44.1**	**3.0**	**0.3**	**47.4**
Capital expenditures, net	**10.9**	**1.3**	**0.9**	**13.1**
Identifiable assets	**707.5**	**63.7**	**96.1**	**867.3**
Year ended December 31, 2009				
Sales to external customers [(b)]	690.0	122.5	1.0	813.5
Sales of pulp to paper segment [(c)]	63.7	(63.7)	-	-
Operating income (loss)	11.7	10.6	(10.3)	12.0
Amortization	45.9	3.3	0.2	49.4
Capital expenditures, net	13.2	0.1	0.2	13.5
Identifiable assets	739.3	64.4	33.9	837.6

(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 37% (2009 – 36%).

(b) Sales to the largest customer represented approximately 12% of pulp segment sales (2009 – 9%).

(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.