# CANFOR PULP INCOME FUND

## Second Quarter Report

For the three and six months ended June 30, 2008

## Canfor Pulp Income Fund and Canfor Pulp Limited Partnership
## Second Quarter 2008
## 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 unaudited interim consolidated 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 and the Fund's performance for the quarter and six months ended June 30, 2008 relative to the same periods in the prior year and relative to the previous quarter. This MD&A should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes as well as the annual MD&A and audited consolidated financial statements and notes which are included in the Fund's 2007 Annual Report. Additional information relating to the Fund and the Partnership, including the Fund's Annual Information Form (AIF) dated February 25, 2008, is available on SEDAR at www.sedar.com or at www.canforpulp.com.*

*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 and before other non-operating income and expenses) and adjusted 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. Adjusted distributable cash is a measure of cash flow used by management to determine the level of cash distributions. EBITDA and adjusted 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 EBITDA, the Partnership's use of this term may not be directly comparable with similarly titled measures used by other companies or income funds.*

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

*The information in this report is as at July 24, 2008.*

### Forward Looking Statements

*Certain statements in this press release constitute "forward-looking statements" which involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results, performance or achievements expressed or implied by such statements. Words such as "expects", "anticipates", "intends", "plans", "will", "believes", "seeks", "estimates", "should", "may", "could" and variations of such words and similar expressions are intended to identify such forward-looking statements. The risks and uncertainties are detailed from time to time in reports filed by the Fund with the securities regulatory authorities in all of the provinces and territories of Canada to which recipients of this press release are referred to for additional information concerning the Fund and Partnership, its prospects and uncertainties relating to the Fund and Partnership and its prospects. These statements are based on management's current expectations and beliefs and actual events or results may differ materially. New risk factors may arise from time to time and it is not possible for management to predict all of those risk factors or the extent to which any factor or combination of factors may cause actual results, performance and achievements of the Fund and Partnership to be materially different from those contained in forward-looking statements. The forward-looking statements are based on current information and expectations and the Fund and Partnership assume no obligation to update such information to reflect later events or developments, except as required by law.*

*Forward-looking statements in this MD&A include statements made under:*

- *“Critical Accounting Estimates” on page 5;*
- *“Markets – Pulp” on page 10, the last paragraph under that heading;*
- *“Outlook – Pulp” on page 10;*
- *“Outlook – Kraft Paper” on page 11;*
- *“Critical Accounting Estimates” on page 14;*
- *“Distributable Cash and Cash Distributions” on page 16.*

*Material risk factors that could cause actual results to differ materially from the forward-looking statements contained in this MD&A include: 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 Fund and Partnership. Additional information concerning these and other factors can be found in the Fund’s Annual Information Form dated February 25, 2008, which is available on www.sedar.com.*

## 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.

At July 24, 2008, there are a total of 35,493,505 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. Under present income tax legislation, 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.

### SELECTED QUARTERLY FUND FINANCIAL INFORMATION

| (thousands of dollars, except per unit amounts, unaudited) | **Q2 2008** | Q1 2008 | Q4 2007 | Q3 2007 | Q2 2007 | Q1 2007 | Q4 2006 | Q3 2006 |
|---|---|---|---|---|---|---|---|---|
| Equity income in Canfor Pulp Limited Partnership | **9,046** | 21,667 | 5,999 | 16,541 | 17,900 | 24,203 | 12,184 | 8,374 |
| Net income (loss)[1] | **7,015** | 21,667 | 8,703 | 16,541 | (21,437) | 24,203 | 12,184 | 8,374 |
| Net income (loss) per Fund unit | **$0.20** | $0.61 | $0.25 | $0.46 | $(0.60) | $0.68 | $0.56 | $0.59 |
| Distributions earned from the Partnership and declared to unitholders | **12,777** | 12,778 | 13,487 | 19,167 | 17,747 | 14,907 | 24,147 | 6,272 |
| Distributions declared per Fund unit | **$0.36** | $0.36 | $0.38 | $0.54 | $0.50 | $0.42 | $0.80 | $0.44 |

Note: [1] In the second quarter of 2007 the Fund recorded a non-cash future income tax charge of $39.3 million to net income relating to the Fund's 49.8% ownership in the Partnership and based on temporary differences between the accounting and tax basis of the Partnership's assets and liabilities expected to reverse after January 1, 2011.

### OPERATING RESULTS AND LIQUIDITY

For the quarter ended June 30, 2008, the Fund had net income of $7.0 million, or $0.20 per Fund unit. Net income is the Fund's share of the Partnership's earnings for the second quarter of 2008, less a future income tax expense of $2.0 million. The future income tax expense represents an adjustment to the future income tax liability based on the Fund's share of the differences between book and income tax values of the Partnership's assets and liabilities. Distributions declared by the Partnership and accruing to the Fund were $12.8 million of which $4.3 million was receivable at June 30, 2008. Cash distributions received from the Partnership are the only source of liquidity for the Fund. The Fund's requirements for administrative services are minimal and are funded and expensed by the Partnership. For further information refer to the Partnership's discussion of operating results and liquidity on pages 7 through 12 of this interim management discussion and analysis.

### 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 business 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 the second quarter of 2008, the Fund declared distributions of $0.36 per Fund unit or $12.8 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, primarily due to differences between capital expenditures, amortization and other non-cash expenses of the Partnership, and reserves for future capital expenditures and contingencies.

## RISKS AND UNCERTAINTIES

The Fund is subject to certain risks and uncertainties related to the nature of its investment in the Partnership and the structure of the Fund, as well as all of the risks and uncertainties related to the business of the Partnership. A comprehensive discussion of these risks and uncertainties is contained in the Fund's Annual Information Form dated February 25, 2008, which is available on www.sedar.com.

## FUND UNITS

At July 24, 2008, there are a total of 35,493,505 Fund units outstanding. During the quarter the Fund redeemed 37 Fund units at a redemption price of $8.065 per unit. The units were redeemed in accordance with the terms of the Declaration of Trust of the Fund.

## RELATED PARTY TRANSACTIONS

All accounting, treasury, legal and administrative functions for the Fund are performed on its behalf, without charge, by the Partnership pursuant to a support agreement. Distributions earned from the Partnership for the three months ended June 30, 2008 were $12.8 million of which $8.5 million was paid, with the balance of $4.3 million receivable on June 30, 2008.

## 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. The determination of the future income tax liability requires management to estimate the future impacts of the Partnership's amortization of capital assets, capital cost allowance claims for tax purposes and changes to actuarial estimates of employee benefit plans. Changes in these estimates could have a material impact on the calculation of the liability.

## CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, the Fund adopted the Canadian Institute of Chartered Accountants' new Handbook Sections; 1535 "Capital Disclosures", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Handbook sections 3862 and 3863 replace section 3861 "Financial Instruments – Disclosure and Presentation". These recommendations have been incorporated into the unaudited interim consolidated financial statements.

*Section 1535 – Capital Disclosures*

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Fund is required to disclose qualitative and quantitative information that enables users of the financial statements to evaluate the Fund's objectives, policies and processes for managing capital.

*Section 3862 – Financial Instruments – Disclosures*

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

*Section 3863 – Financial Instruments – Presentation*

This Section establishes standards for presentation of financial instruments and non-financial derivatives.

## CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

On February 13, 2008, the Accounting Standards Board announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS") for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The Fund is currently developing a conversion implementation plan and assessing the impacts of the conversion on the consolidated financial statements and disclosures of the Fund.

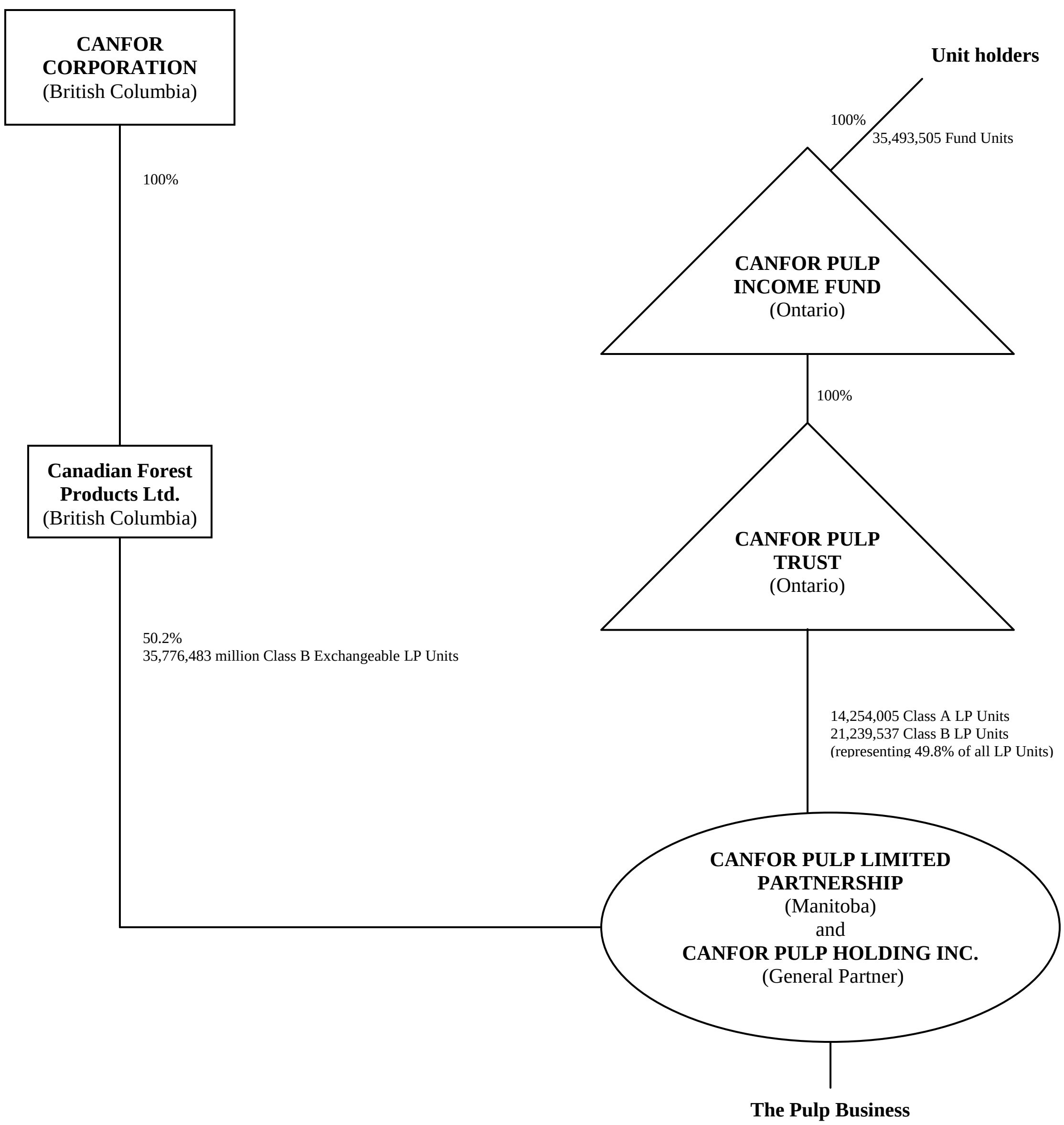
## CANFOR PULP LIMITED PARTNERSHIP

### Structure

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 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).

At July 24, 2008, 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. Below is a simplified schematic of the ownership structure.

**Partnership Structure**



## 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 140,000 tonnes of kraft paper.

### SUMMARY OF SELECTED PARTNERSHIP RESULTS

| (millions of dollars, except for per unit amounts, unaudited) | **Q2 2008** | Q1 2008 | **YTD 2008** | Q2 2007 | YTD 2007 |
|---|---|---|---|---|---|
| Sales | **212.6** | 211.4 | **424.0** | 239.4 | 477.6 |
| EBITDA [1] | **24.0** | 42.5 | **66.5** | 51.7 | 111.8 |
| Operating income | **11.6** | 30.6 | **42.2** | 39.2 | 87.2 |
| Net income | **18.2** | 43.5 | **61.7** | 35.9 | 84.5 |
| Per Partnership unit, basic and diluted | | | | | |
| Net income | **0.26** | 0.61 | **0.87** | 0.51 | 1.19 |
| EBITDA | **0.33** | 0.60 | **0.93** | 0.73 | 1.57 |
| Average exchange rate (US$/Cdn$) [2] | **0.990** | 0.996 | **0.993** | 0.911 | 0.881 |

Notes: [1] For calculation of EBITDA, see supplementary financial information on page 16.
[2] Source – Bank of Canada (average noon rate for the period).

EBITDA for the second quarter of 2008 decreased by $18.5 million from the first quarter of 2008 and decreased by $27.7 million when compared to the second quarter of 2007. The decrease from the first quarter is mainly attributable to the impact of scheduled maintenance outages and higher freight and fibre costs. Increased costs and reduced production from the scheduled maintenance outages in the second quarter of 2008 reduced EBITDA by approximately $12 million. Realized pulp prices in Canadian dollar terms decreased slightly as the sales product and geographic mix more than offset the impact of a weaker Canadian dollar. The Bank of Canada noon rate averaged 0.6% lower than the previous quarter. Freight costs rose 6% over the previous quarter as higher fuel surcharges increased costs of delivering pulp and paper to our customers. Higher fuel costs also contributed to a 3% increase in delivered fibre costs when compared to the first quarter of 2008.

When compared to the second quarter of 2007 the $27.7 million decrease in EBITDA was attributable to lower production and sales volumes, higher unit manufacturing costs and the stronger Canadian dollar partially offset by increases in NBSK pulp list prices. The unfavourable impact of the stronger Canadian dollar was approximately $16 million when compared to the same period last year. Unit manufacturing costs increased 16% when compared to the second quarter of 2007 due to higher fibre, energy and maintenance costs and the impact of lower production volumes due to the scheduled maintenance outage at Northwood Pulp mill in the second quarter of 2008. Quarter over quarter fibre costs increased 15% due to a higher sawmill residual price and a higher percentage of whole log chip consumption. NBSK pulp list prices increased approximately 9% offsetting some of the impact of the stronger Canadian dollar and the cost increases.

For the six month period ended June 30, 2008, EBITDA of $66.5 million decreased $45.3 million when compared to the same period in 2007. The decrease in EBITDA is attributable to the stronger Canadian dollar, lower sales volumes and higher unit manufacturing costs, partially offset by increased NBSK pulp list prices. The Canadian dollar strengthened by 13%, an unfavourable impact of $45 million over the same period in the prior year. Sales volumes decreased by 8% when compared to the prior year due to the impact of the Prince George Pulp Mill fire and scheduled maintenance downtime in 2008. Unit manufacturing costs increased by 14% due to the impact of lower production volumes and higher maintenance, energy and fibre costs.

## OPERATING RESULTS BY BUSINESS SEGMENT

### Pulp

| (millions of dollars unless otherwise noted, unaudited) | **Q2 2008** | Q1 2008 | **YTD 2008** | Q2 2007 | YTD 2007 |
|---|---|---|---|---|---|
| Sales | **178.6** | 176.6 | **355.2** | 205.0 | 412.7 |
| EBITDA [1] | **24.1** | 44.0 | **68.1** | 55.3 | 119.4 |
| EBITDA margin [1] | **13%** | 25% | **19%** | 27% | 29% |
| Operating income [1] | **12.8** | 33.0 | **45.8** | 43.8 | 96.9 |
| Average NBSK pulp list price – (US$ per tonne, delivered to USA) | **880** | 880 | **880** | 810 | 800 |
| Average NBSK pulp list price – (Cdn$ per tonne, delivered to USA) | **889** | 884 | **886** | 889 | 908 |
| Production – pulp (000 mt) | **226.1** | 231.5 | **457.6** | 258.3 | 517.2 |
| Shipments – Partnership-produced pulp (000 mt) | **233.8** | 228.9 | **462.7** | 259.8 | 512.9 |
| *Marketed on behalf of HSLP & Canfor (000 mt)* | **151.9** | 128.4 | **280.3** | 152.1 | 284.7 |

Note: [1] Comparative figures have been reclassified to conform to current year presentation.

Second quarter 2008 operating income of the pulp segment decreased by $20.2 million from the first quarter of 2008 and $31.0 million when compared to the second quarter in 2007. Compared to the first quarter of 2008, the decrease is primarily due to the impact of scheduled maintenance outages, higher fibre costs and lower realized prices in Canadian dollar terms. Increased operating and maintenance costs and reduced production resulting from the scheduled maintenance outages in the second quarter of 2008 reduced operating earnings by approximately $12 million. Higher fuel costs increased both the cost of delivering pulp to customers and the delivered cost of fibre to the mills. Overall realized pulp prices in Canadian dollar terms decreased by 1%, primarily the result of higher freight costs and a higher percentage of unbleached pulp sales. Pulp production volume lost as a result of the Prince George Pulp Mill fire and subsequent operation using the temporary chip screening system is approximately 6,000 tonnes in the second quarter of 2008 and 35,000 tonnes in the first quarter of 2008. The financial impact of this reduced production volume is offset by accrued business interruption insurance recoveries of $3.3 million in the second quarter of 2008 and $11.4 million in the first quarter of 2008.

The second quarter 2008 results are lower than those in the same period a year ago, due to the impact of the stronger Canadian dollar, lower production and sales volumes, and higher unit manufacturing costs which were partially offset by increases in NBSK pulp list prices. The impact of the stronger Canadian dollar was approximately $14 million when compared to the same period last year. Lower production and sales volumes and higher maintenance costs were the direct result of scheduled maintenance outages. Fibre costs increased 15% over the prior year quarter mainly attributable to a higher percentage of higher cost whole log chip consumption, combined with increased freight costs. Also impacting unit manufacturing costs were higher energy costs primarily attributable to a 21% increase in natural gas prices, which were partially offset by an 8% reduction in natural gas usage. Increased NBSK pulp list prices of approximately 9% offset some of the impact of the stronger Canadian dollar and increased costs.

For the six month period ended June 30, 2008, operating income of $45.8 million decreased $51.1 million when compared to the same period in 2007. The decrease is attributable to the stronger Canadian dollar, lower sales volumes and higher unit manufacturing costs, partially offset by increased NBSK pulp list prices. The Canadian dollar strengthened by 13%, an unfavourable impact of $39 million over the same period in the prior year. Sales volumes decreased by 10% when compared to the prior year due to the impact of the Prince George Pulp Mill fire and scheduled maintenance downtime in 2008. Offsetting the impact of the fire was an accrual of $14.7 million for business interruption insurance on the impact of lost production. Unit manufacturing costs increased by 14% due to the impact of lower production volumes and higher maintenance, energy costs and fibre costs. Fibre costs increased by 14% when compared to the prior year, due to higher prices for residual chips and a higher percentage of whole log chips. Pulp realized prices in Canadian dollar terms decreased by 5% as the impacts of the stronger Canadian dollar were partially offset by a 10% increase in pulp list prices.

*Operations*

NBSK production during the second quarter was 5,400 tonnes less than the first quarter of 2008, and 32,200 tonnes less than the second quarter of 2007. The Prince George Pulp Mill continues to operate at a slightly reduced rate due to operation on a temporary chip screening system. Construction of a permanent system is underway and expected to be operational in the fourth quarter of 2008. Pulp production volume lost as a result of the fire and subsequent operation using the temporary system is approximately 6,000 tonnes of reduced production in the quarter as compared to approximately 35,000 tonnes in the first quarter of 2008. Scheduled maintenance outages were taken at the Northwood and Intercontinental Pulp Mills in the second quarter of 2008 representing approximately 33,000 tonnes of reduced production with no scheduled maintenance outages in the first quarter of 2008. Reduced production in respect of scheduled maintenance outages in 2007 are approximately 8,600 tonnes in the second quarter and 17,000 tonnes for the six months ended June 30, 2007.

*Markets*

The pulp market remained balanced through the second quarter of 2008. Market pulp inventories (World 20 Producers) of softwood kraft market pulp were at 29 days of supply[1] at the end of the second quarter, a reduction of four days from the level at the end of the preceding quarter. Inventories of 30 days are generally considered to be representative of a balanced market. Shipments in the first six months of 2008 of softwood kraft market pulp were similar to those in the same period in 2007. The global printing and writing paper sector, which is the Partnership's largest customer sector for its pulp, experienced a reduction in demand of 1.7% in the first five months of 2008 relative to the same period in 2007.

Supply concerns continued to impact market conditions in the second quarter of 2008 helping to maintain a balanced market and offsetting paper demand reductions, primarily in the USA. The relative strength of the Canadian dollar and the Euro compared to the US dollar continued to negatively impact revenues of Canadian and European producers. Fibre costs for these same producers continue to rise, adding to the financial strain and viability concerns of some higher cost producing mills. Adding to supply concerns is the reduced availability of fibre for Canadian pulp mills. The slowdown in the USA housing market has reduced demand for lumber resulting in closures of sawmills and reduced supply of residual woodchips. Market conditions were also impacted by the slowed global economic growth, resulting in a reduction in demand in the latter part of the quarter.

Note: [1] Pulp and Paper Products Council (PPPC)

*Outlook – Pulp*

A US$20 per tonne price increase has been announced for North American markets effective July 1, which would take the price to US$900 per tonne. The European market price is currently at US$900 per tonne. Historically, pulp consumption and demand slows during the summer period. However, this demand slowdown is expected to be offset by reduced NBSK production as a result of mill closures. The expected result is that softwood market pulp will trade in a narrow price range for the balance of the year.

**Paper**

| (millions of dollars unless otherwise noted, unaudited) | **Q2 2008** | Q1 2008 | **YTD 2008** | Q2 2007 | YTD 2007 |
|---|---|---|---|---|---|
| Sales | **34.0** | 34.8 | **68.8** | 34.4 | 64.9 |
| EBITDA [1] | **3.1** | 2.3 | **5.4** | 0.5 | 1.3 |
| EBITDA margin [1] | **9%** | 7% | **8%** | 1% | 2% |
| Operating income (loss) [1] | **2.1** | 1.4 | **3.5** | (0.5) | (0.7) |
| Production – paper (000 mt) | **34.2** | 32.4 | **66.6** | 33.9 | 65.5 |
| Shipments – paper (000 mt) | **33.7** | 35.1 | **68.8** | 35.9 | 66.3 |

Note: [1] Comparative figures have been reclassified to conform to current year presentation.

Operating income of the paper segment for the second quarter of 2008 was $2.1 million, $0.7 million higher than the first quarter of 2008 and $2.6 million higher than second quarter last year. The improvement over the first quarter of

2008 was due to a 2% improvement in realized prices in Canadian dollar terms and lower unit manufacturing costs, partially offset by lower sales volumes. The decrease in manufacturing costs was primarily the result of lower raw material costs for slush pulp. When compared to the second quarter of 2007 the improved operating earnings were due to a 5% increase in realized prices in Canadian dollar terms and lower unit manufacturing costs, partially offset by lower sales volumes.

For the six month period ending June 30, 2008, operating income of $3.5 million increased by $4.2 million when compared to the same period in 2007. The increase was attributable to a 2% increase in realized prices in Canadian dollar terms, higher sales volumes and lower unit manufacturing costs due to lower raw material costs for slush pulp.

*Operations*

Paper production in the second quarter of 2008 increased by 1,800 tonnes over the first quarter of 2008 and 300 tonnes when compared to the second quarter of 2007. In the first quarter of 2008, the fire at the Prince George Pulp and Paper Mill resulted in reduced production of approximately 2,500 tonnes. There was no scheduled maintenance taken during the first two quarters of 2008 or the second quarter of 2007.

*Markets*

In the second quarter, the largest market for the Partnership's paper products which is North America, was characterized by steady demand and reduced imports. These factors provided opportunities for an increased percentage of higher margin bleached paper sales.

Price increases for July 1, 2008 of US$50 per tonne are in place entering the third quarter of 2008. Cost pressures continue for North American paper packaging producers due to the increases in energy, chemicals and transportation costs. These increased costs combined with concerns of reduced supply are expected to continue to exert upward pressure on prices through the remainder of the year.

*Outlook – Kraft Paper Markets*

Prices are expected to remain strong through the second half of 2008 as all paper packaging grades have experienced increases in production costs and concerns of reduced supply are expected to continue to affect the market.

**Non-Segmented Costs**

| (millions of dollars, unaudited) | **Q2 2008** | Q1 2008 | **YTD 2008** | Q2 2007 | YTD 2007 |
|---|---|---|---|---|---|
| Unallocated costs | **3.3** | 3.8 | **7.1** | 4.1 | 9.0 |
| Interest expense, net | **1.7** | 1.7 | **3.4** | 1.6 | 3.4 |
| Unrealized (gain) loss on derivative instruments | **(8.0)** | (6.9) | **(14.9)** | 4.2 | 2.0 |
| Unrealized foreign exchange (gain) loss on long-term debt | **(0.6)** | 3.3 | **2.7** | (9.8) | (11.2) |
| Foreign exchange (gain) loss on working capital | **0.3** | (2.6) | **(2.3)** | 7.2 | 8.3 |
| Net property damage insurance gain | **-** | (8.5) | **(8.5)** | - | - |
| Other expense | **-** | 0.1 | **0.1** | 0.1 | 0.2 |
| | **(3.3)** | (9.1) | **(12.4)** | 7.4 | 11.7 |

*Unallocated Costs*

Unallocated costs, comprised principally of general and administrative expenses, totalled $3.3 million in the second quarter of 2008 compared to $3.8 million in the first quarter of 2008 and $4.1 million in the second quarter of 2007. Unallocated costs were down slightly when compared to the first quarter of 2008 due to lower accruals for performance based incentive plan payments. When compared to the second quarter of 2007 the lower costs are attributable to lower accruals for performance based incentive plans and a reduction in corporate services provided from Canfor.

*Interest Expense*

The net interest expense during the second quarter of 2008 was similar to the previous quarter and the second quarter of 2007.

*Other Non-segmented Items*

The net unrealized gain of $8.0 million recorded in the quarter relates to a revaluation to market of outstanding natural gas swaps at the end of the quarter and is the result of increases in the market price of natural gas. The natural gas swaps are used to fix the price on a portion of the Partnership's future natural gas requirements.

The foreign exchange gain on long-term debt and the foreign exchange loss on working capital are the direct result of translating US dollar balances at period-end exchange rates and reflect the effect of the weaker Canadian dollar.

**SUMMARY OF FINANCIAL POSITION**

The following table summarizes the Partnership's financial position as at the end of and for the following periods:

| (millions of dollars, except for ratios, unaudited) | **Q2 2008** | **YTD 2008** | Q2 2007 | YTD 2007 |
|---|---|---|---|---|
| Ratio of current assets to current liabilities | **1.91** | **1.91** | 1.86 | 1.86 |
| Ratio of net debt to partners' equity [1] | **0.20** | **0.20** | 0.14 | 0.14 |
| Increase (decrease) in cash and cash equivalents | **(20.5)** | **(0.2)** | 6.0 | 5.7 |
| Comprised of cash flow from (used in): | | | | |
| Operating activities [2] | **4.9** | **56.5** | 43.6 | 92.1 |
| Financing activities | **(20.7)** | **(46.3)** | (32.8) | (78.4) |
| Investing activities [2] | **(4.7)** | **(10.4)** | (4.8) | (8.0) |

Notes: [1] Net debt consists of long-term debt and operating loans, net of cash and cash equivalents.
[2] Comparative figures have been reclassified to conform to current year presentation.

**Changes in Financial Position**

Cash generated from operating activities was $4.9 million in the second quarter of 2008 compared to $43.6 million in the second quarter of 2007. The decrease was due to lower cash generated as a result of reduced earnings and an increase of cash used in working capital. The increase of cash used in working capital is due to an increase in prepaid expenses for deferred maintenance shutdown expenses, increased cost and volume of chip inventories, and an increase in trade receivables primarily due to higher pulp shipments in the second quarter of 2008, partially offset by a reduction in the insurance receivable for proceeds relating to the business interruption insurance claim.

The cash used in financing activities of $20.7 million in the quarter represents $25.7 million of distributions paid to the limited partners, namely Canfor and the Fund, offset by $5.0 million from the Partnership's operating line.

The cash used in investing activities in the quarter is comprised of $9.1 million relating to capital expenditures net of accruals, offset by a cash advance of $4.4 million received as partial payment against the accrued property damage insurance receivable.

## LIQUIDITY AND FINANCIAL REQUIREMENTS

At the end of the current quarter, the Partnership had cash and cash equivalents totalling $2.4 million. Cash and cash equivalents include cash on hand and highly liquid investments with an original maturity date of 90 days or less. The Partnership does not have holdings in asset backed commercial paper. The Partnership has a $75 million syndicated unsecured revolving bank credit facility (the Revolving Facility), maturing in November 2009, of which $42.6 million is available with $27.4 million of the Revolving Facility reserved for a standby letter of credit issued to BC Hydro and $5.0 million drawn to fund working capital requirements as of June 30, 2008.

## OUTSTANDING UNITS

At July 24, 2008, there were 71,270,025 Limited Partnership Units outstanding, of which 35,493,542 units (consisting of 14,254,005 Class A Limited Partnership Units and 21,239,537 Class B Limited Partnership Units) are owned by the Fund through Canfor Pulp Trust and 35,776,483 Class B Exchangeable Limited Partnership Units are owned indirectly by Canfor.

## RELATED PARTY TRANSACTIONS

The Partnership's transactions with related parties are consistent with the transactions described in the December 31, 2007 audited consolidated financial statements and are based on agreed upon amounts, and are summarized in note 12 of the unaudited interim consolidated financial statements.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ending June 30, 2008, there were no changes in the Partnership's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

## RISKS AND UNCERTAINTIES

A comprehensive discussion of risks and uncertainties is included in the Fund's Annual Information Form dated February 25, 2008, which is available on www.sedar.com.

## SELECTED QUARTERLY PARTNERSHIP FINANCIAL INFORMATION

| (unaudited) | **Q2 2008** | Q1 2008 | Q4 2007 | Q3 2007 | Q2 2007 | Q1 2007 | Q4 2006 | Q3 2006 |
|---|---|---|---|---|---|---|---|---|
| **Sales and Income** (millions of dollars) | | | | | | | | |
| Sales [1] | **212.6** | 211.4 | 215.1 | 228.9 | 239.4 | 238.2 | 225.2 | 213.6 |
| Operating income [1] | **11.6** | 30.6 | 11.7 | 35.4 | 39.2 | 48.0 | 45.6 | 49.0 |
| EBITDA [1] | **24.0** | 42.5 | 27.9 | 48.8 | 51.7 | 60.1 | 58.2 | 61.8 |
| Net income | **18.2** | 43.5 | 12.1 | 33.2 | 35.9 | 48.6 | 44.8 | 41.9 |
| **Per Partnership unit** (dollars) [2] | | | | | | | | |
| Net income basic and diluted | **0.26** | 0.61 | 0.17 | 0.46 | 0.51 | 0.68 | 0.63 | 0.59 |
| **Statistics** | | | | | | | | |
| Pulp shipments (000 mt) | **233.8** | 228.9 | 253.6 | 257.1 | 259.8 | 253.1 | 249.8 | 251.4 |
| Paper shipments (000 mt) | **33.7** | 35.1 | 32.4 | 30.8 | 35.9 | 30.4 | 32.7 | 29.5 |
| Average exchange rate (US$/Cdn$) [3] | **0.990** | 0.996 | 1.019 | 0.957 | 0.911 | 0.854 | 0.878 | 0.892 |
| Average NBSK pulp list price – (US$ per tonne, delivered to USA) | **880** | 880 | 857 | 837 | 810 | 790 | 770 | 757 |

Notes: [1] Comparative figures have been reclassified to conform to current year presentation.
[2] Based on Partnership units outstanding at June 30, 2008 (71,270,025) for all periods.
[3] Source – Bank of Canada (average noon rate for the period).

Sales are primarily influenced by changes in market pulp prices, sales volumes and fluctuations in Canadian dollar exchange rates. Operating income, net income and EBITDA are primarily impacted by the level of sales and price fluctuations in raw material inputs, freight costs, energy prices, maintenance costs and the timing of scheduled maintenance downtime. Net income is also impacted by fluctuations in the Canadian dollar and market price of natural gas, due to the revaluation to the period end rate of US dollar denominated working capital balances and the US dollar denominated long-term debt, and revaluation of outstanding natural gas commodity swaps. Included in the first quarter of 2008 net income is a $8.5 million net gain for property damage insurance, relating to the fire at the Prince George Pulp and Paper Mill. The third quarter of 2006 also included a charge for transaction costs of $5.9 million related to the spinout of Canfor's pulp business into the Partnership.

## 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. On an ongoing basis, management reviews its estimates, including those related to useful lives for amortization, impairment of long-lived assets, pension and other employee future benefit plans and asset retirement obligations based upon currently available information. While it is reasonably possible that circumstances may arise which cause actual results to differ from these estimates, management does not believe it is likely that any such differences will materially affect the Partnership's financial condition.

## CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, the Partnership adopted the Canadian Institute of Chartered Accountants' new Handbook Sections; 1535 "Capital Disclosures", 3031 "Inventories", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Handbook sections 3862 and 3863 replace section 3861 "Financial Instruments – Disclosure and Presentation". These recommendations have been incorporated into the unaudited interim consolidated financial statements.

*Section 1535 – Capital Disclosures*

This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard the Partnership is required to disclose qualitative and quantitative information that enables users of the financial statements to evaluate the Partnership's objectives, policies and processes for managing capital.

*Section 3031 – Inventories*

This Section replaces section 3030 and prescribes the accounting treatment for inventories and provides guidance on the determination of costs and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on assigning costs to inventories and in conjunction with section 3061 "Property Plant and Equipment", provides guidance on classification of major spare parts.

As a result of its adoption of the new guidance, the Partnership reclassified $6.8 million in major spare parts from inventory to property, plant and equipment in the first quarter of 2008. This reclassification was made retrospectively, without prior period restatement or adjustments to opening equity as it was deemed impracticable to determine the impact on prior periods.

*Section 3862 – Financial Instruments – Disclosures*

This Section requires entities to provide disclosure of quantitative and qualitative information in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

*Section 3863 – Financial Instruments – Presentation*

This Section establishes standards for presentation of financial instruments and non-financial derivatives.

**CONVERSION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS**

On February 13, 2008, the Accounting Standards Board announced that publicly accountable entities will be required to prepare financial statements in accordance with International Financial Reporting Standards ("IFRS") for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The Partnership is currently developing a conversion implementation plan and assessing the impacts of the conversion on the consolidated financial statements and disclosures of the Partnership.

**CANFOR PULP LIMITED PARTNERSHIP**

**SUPPLEMENTARY FINANCIAL INFORMATION**

| (millions of dollars, unaudited) | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **June 30, 2008** | June 30, 2007 | **June 30, 2008** | June 30, 2007 |
| **RECONCILIATION OF NET INCOME TO EBITDA** | | | | |
| **Net Income** | **$ 18.2** | $ 35.9 | **$ 61.7** | $ 84.5 |
| Add (deduct): | | | | |
| Amortization | **12.0** | 12.5 | **23.6** | 24.6 |
| Net interest expense | **1.7** | 1.6 | **3.4** | 3.4 |
| Unrealized foreign exchange (gain) loss on long-term debt | **(0.6)** | (9.8) | **2.7** | (11.2) |
| Unrealized (gain) loss on derivative instruments | **(8.0)** | 4.2 | **(14.9)** | 2.0 |
| Foreign exchange (gain) loss on working capital | **0.3** | 7.2 | **(2.3)** | 8.3 |
| Loss on disposal of fixed assets | **0.3** | - | **0.5** | - |
| Net property damage insurance gain | **-** | - | **(8.5)** | - |
| Other expense | **0.1** | 0.1 | **0.3** | 0.2 |
| **EBITDA** | **$ 24.0** | $ 51.7 | **$ 66.5** | $ 111.8 |
| **EBITDA per Partnership unit** | **$ 0.33** | $ 0.73 | **$ 0.93** | $ 1.57 |

| (millions of dollars, unaudited) | Three months ended | | Six months ended | |
|---|---|---|---|---|
| | **June 30, 2008** | June 30, 2007 | **June 30, 2008** | June 30, 2007 |
| **CALCULATION OF STANDARDIZED AND ADJUSTED DISTRIBUTABLE CASH** | | | | |
| **Cash flow from operating activities** | **$ 4.9** | $ 43.6 | **$ 56.5** | $ 92.1 |
| Deduct: Capital expenditures – cash | **(9.1)** | (4.8) | **(18.4)** | (8.0) |
| **Standardized distributable cash** | **$ (4.2)** | $ 38.8 | **$ 38.1** | $ 84.1 |
| **Adjustments to standardized distributable cash:** | | | | |
| Add (deduct): | | | | |
| Increase in non-cash working capital | **15.0** | 2.0 | **10.0** | 8.6 |
| Net long-term deferred maintenance | **3.1** | (1.5) | **2.1** | (2.0) |
| Capital expenditures – accruals | **(0.5)** | (2.4) | **5.6** | (2.4) |
| **Adjusted distributable cash [1]** | **$ 13.4** | $ 36.9 | **$ 55.8** | $ 88.3 |
| Standardized distributable cash – per Partnership unit (in dollars) | **$ (0.06)** | $ 0.54 | **$ 0.53** | $ 1.18 |
| Adjusted distributable cash – per Partnership unit (in dollars) [1] | **$ 0.19** | $ 0.52 | **$ 0.78** | $ 1.24 |
| **Cash distributions declared (paid and payable)** | **$ 25.7** | $ 35.6 | **$ 51.3** | $ 65.5 |
| Cash distributions declared – per Partnership unit (in dollars) | **$ 0.36** | $ 0.50 | **$ 0.72** | $ 0.92 |

Note: [1] Comparative figures have been reclassified to conform to current year presentation.

**DISTRIBUTABLE CASH AND CASH DISTRIBUTIONS**

In accordance with the Canadian Institute of Chartered Accountants July 2007 interpretive release "Standardized Distributable Cash in Income Trusts and other Flow-Through Entities", the Partnership has adopted the distributable cash calculation which conforms with the current guidance. In summary, for the purposes of the Partnership, standardized distributable cash is defined as the periodic cash flows from operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital less total capital expenditures as reported in the GAAP financial statements.

Adjusted distributable cash is defined as the standardized distributable cash prior to the effects of changes in non-cash working capital and long-term deferred maintenance, and after provision for accrued capital expenditures.

Management determines the level of cash distributions based on the level of cash flow from operations before working capital changes less actual capital expenditures, a reserve for future major capital replacements (estimated at $4 million per year) and a contingency reserve. 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 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.

Distributions are declared monthly with date of record on the last day of the month and payable within 15 days following.