# 2014

Canfor Pulp Products Inc.

# interim report

## quarter two

for the three months ended june 30, 2014

Canfor Pulp

## To Our Shareholders

Canfor Pulp Products Inc. ("CPPI") reported net income of $18.8 million, or $0.27 per share, for the second quarter of 2014, compared to $25.7 million, or $0.36 per share, for the first quarter of 2014 and $7.6 million, or $0.11 per share, for the second quarter of 2013. For the six months ended June 30, 2014, the Company's net income was $44.5 million, or $0.63 per share, compared to $18.5 million, or $0.26 per share, for the six months ended June 30, 2013.

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

| (millions of Canadian dollars, except per share amounts) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| Sales | **$ 252.5** | $ 226.4 | **$ 478.9** | $ 227.6 | $ 445.1 |
| Operating income | **$ 29.6** | $ 36.4 | **$ 66.0** | $ 19.5 | $ 38.5 |
| Net income | **$ 18.8** | $ 25.7 | **$ 44.5** | $ 7.6 | $ 18.5 |
| Net income per share, basic and diluted | **$ 0.27** | $ 0.36 | **$ 0.63** | $ 0.11 | $ 0.26 |
| Adjusted net income | **$ 18.4** | $ 26.7 | **$ 45.1** | $ 15.4 | $ 27.8 |
| Adjusted net income per share, basic and diluted | **$ 0.26** | $ 0.37 | **$ 0.64** | $ 0.22 | $ 0.39 |

After adjusting for items affecting comparability with the prior periods, the Company's adjusted net income for the second quarter of 2014 was $18.4 million, or $0.26 per share, compared to an adjusted net income of $26.7 million, or $0.37 per share, for the first quarter of 2014. CPPI's adjusted net income for the second quarter of 2013 was $15.4 million, or $0.22 per share.

The Company reported operating income of $29.6 million for the second quarter of 2014, a decrease of $6.8 million from operating income of $36.4 million for the first quarter of 2014, as the impact of pulp and paper maintenance outages and higher fibre costs more than offset higher pulp and paper shipments. In addition, despite slight increases in the average Northern Bleached Softwood Kraft ("NBSK") pulp prices to North America and Europe, pulp unit sales realizations experienced a small decrease compared to the previous quarter due to a combination of weaker prices to China, a slightly stronger Canadian dollar and a higher proportion of shipments to lower-margin markets, including Asia, mostly tied to constraints in the previous quarter due to the Vancouver Port truckers' strike.

Global softwood pulp markets were steady through the second quarter of 2014. Softwood pulp demand was solid across all regions and global softwood pulp producer inventory levels tightened through the quarter, decreasing 3 days from the end of March 2014 to 25 days' supply in June 2014, partly reflecting supply constraints due to seasonal maintenance downtime (market conditions are generally considered balanced when inventories are in the 27-30 days of supply range). The North American NBSK pulp list price was stable over the quarter averaging US$1,030 per tonne, up US$13 per tonne, or 1%, compared to the first quarter of 2014. Discount levels were consistent with the previous quarter. The NBSK pulp list price to Europe also remained largely unchanged, averaging US$925 per tonne, up US$5 per tonne from the previous quarter, while the average NBSK pulp list price to China was down US$27 per tonne, or 4%, to US$730 per tonne.

Pulp shipments were up 11% from the previous quarter, largely attributable to improved transportation performance following the challenges experienced in the prior quarter. Pulp production levels were down 8% from the previous quarter principally related to the maintenance outages at the Intercontinental and Prince George Pulp Mills, which reduced market pulp production by 18,000 tonnes. Pulp unit manufacturing costs were up moderately compared to the previous quarter, mostly due to the aforementioned maintenance outages and increased fibre costs, partially offset by seasonally lower energy costs. The higher unit fibre costs reflected higher delivered sawmill residual and whole log chip costs and seasonal factors.

The Company's paper segment's operating income was down $0.7 million from the previous quarter, with the impact of a maintenance outage of the Prince George Kraft paper machine partially offset by higher shipment levels reflecting the improved transportation performance.

NBSK pulp markets are steady heading into the seasonally slower third quarter of 2014. For the month of July 2014, the Company announced NBSK pulp list prices of US$1,030 per tonne in North America and US$730 per tonne in China, both unchanged from June 2014. A risk of price weakness remains for the second half of 2014 due in part to reduced global consumption during the historically slower summer months and new hardwood pulp capacity projected to flow into markets.

Early in July, the Company's operations experienced some disruptions which impacted production by approximately 10,000 tonnes; the mills have now returned to normal operating rates. A maintenance outage originally planned at the Northwood Pulp Mill in the third quarter of 2014 has been deferred to the fourth quarter of 2014 and is projected to reduce production by 10,000 tonnes.

On July 23, 2014, the Board of Directors declared a quarterly dividend of $0.0625 per share with a declaration date of July 23, 2014, payable on August 12, 2014, to the shareholders of record on August 5, 2014.

**Michael J. Korenberg**
**Chairman**

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

**Canfor Pulp Products Inc.**
**Second Quarter 2014**
**Management's Discussion and Analysis**

*This interim Management's Discussion and Analysis ("MD&A") provides a review of Canfor Pulp Products Inc.'s ("CPPI" or "the Company") financial performance for the quarter ended June 30, 2014 relative to the quarters ended March 31, 2014 and June 30, 2013, and the financial position of the Company at June 30, 2014. It should be read in conjunction with CPPI's unaudited interim consolidated financial statements and accompanying notes for the quarters ended June 30, 2014 and 2013, as well as the 2013 annual MD&A and the 2013 audited consolidated financial statements and notes thereto, which are included in CPPI's Annual Report for the year ended December 31, 2013 (available at www.canforpulp.com). The financial information in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS"), which is the required reporting framework for Canadian publicly accountable enterprises.*

*Throughout this discussion, reference is made to Operating Income before Amortization which CPPI considers to be a relevant indicator for measuring trends in the Company's performance and its ability to generate funds to meet its debt service and capital expenditure requirements, and to pay dividends. Reference is also made to Adjusted Net Income (Loss) (calculated as Net Income (Loss) less specific items affecting comparability with prior periods – for the full calculation, see reconciliation included in the section "Analysis of Specific Material Items Affecting Comparability of Net Income (Loss)") and Adjusted Net Income (Loss) per Share (calculated as Adjusted Net Income (Loss) divided by weighted average number of shares outstanding during the period). Operating Income before Amortization, Adjusted Net Income (Loss) and Adjusted Net Income (Loss) per Share are not a generally accepted earnings measures and should not be considered as an alternative to net income or cash flows as determined in accordance with IFRS. As there is no standardized method of calculating these measures, CPPI's Operating Income before Amortization, Adjusted Net Income (Loss) and Adjusted Net Income (Loss) per Share may not be directly comparable with similarly titled measures used by other companies. Reconciliations of Operating Income before Amortization to Operating Income (Loss) and Adjusted Net Income (Loss) to Net Income (Loss) reported in accordance with IFRS are included in this MD&A.*

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

*All financial references are in millions of Canadian dollars unless otherwise noted. The information in this report is as at July 23, 2014.*

***Forward Looking Statements***

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

## SECOND QUARTER 2014 OVERVIEW

Selected Financial Information and Statistics

| (millions of Canadian dollars, except per share amounts) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| Operating income (loss) by segment: | | | | | |
| Pulp | **$ 28.8** | $ 35.0 | **$ 63.8** | $ 15.4 | $ 30.8 |
| Paper | **$ 3.8** | $ 4.5 | **$ 8.3** | $ 7.1 | $ 13.0 |
| Unallocated | **$ (3.0)** | $ (3.1) | **$ (6.1)** | $ (3.0) | $ (5.3) |
| **Total operating income** | **$ 29.6** | $ 36.4 | **$ 66.0** | $ 19.5 | $ 38.5 |
| Add: Amortization | **$ 15.2** | $ 16.0 | **$ 31.2** | $ 19.0 | $ 37.9 |
| **Total operating income before amortization** | **$ 44.8** | $ 52.4 | **$ 97.2** | $ 38.5 | $ 76.4 |
| Add (deduct): | | | | | |
| Working capital movements | **$ 10.7** | $ (19.9) | **$ (9.2)** | $ 5.5 | $ (1.7) |
| Defined benefit pension plan contributions | **$ (1.3)** | $ (2.5) | **$ (3.8)** | $ (2.5) | $ (5.3) |
| Other operating cash flows, net | **$ (2.6)** | $ (6.1) | **$ (8.7)** | $ 3.1 | $ 3.5 |
| **Cash from operating activities** | **$ 51.6** | $ 23.9 | **$ 75.5** | $ 44.6 | $ 72.9 |
| Add (deduct): | | | | | |
| Dividends paid | **$ (4.5)** | $ (3.5) | **$ (8.0)** | $ (3.6) | $ (7.2) |
| Finance expenses paid | **$ (0.6)** | $ (0.8) | **$ (1.4)** | $ (3.8) | $ (4.0) |
| Capital additions, net[1] | **$ (20.2)** | $ (10.0) | **$ (30.2)** | $ (7.9) | $ (14.8) |
| Share purchases | **$ -** | $ - | **$ -** | $ (1.0) | $ (1.0) |
| Other, net | **$ -** | $ - | **$ -** | $ 0.1 | $ 0.2 |
| **Change in cash / operating loans** | **$ 26.3** | $ 9.6 | **$ 35.9** | $ 28.4 | $ 46.1 |
| ROIC – Consolidated period-to-date[2] | **4.0%** | 5.8% | **9.8%** | 3.6% | 6.6% |
| **Average exchange rate (US$ per C$1.00)[3]** | **$ 0.917** | $ 0.906 | **$ 0.912** | $ 0.977 | $ 0.984 |

[1] Additions to property, plant and equipment are shown net of amounts received under Government funding initiatives.
[2] Consolidated Return on Invested Capital ("ROIC") is equal to operating income, plus realized gains/losses on derivatives and other income/expense, divided by the average invested capital during the period. Invested capital is equal to capital assets, plus long-term investments and net non-cash working capital.
[3] Source – Bank of Canada (average noon rate for the period).

Analysis of Specific Material Items Affecting Comparability of Net Income

| After-tax impact (millions of Canadian dollars, except per share amounts) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| **Net income, as reported** | **$ 18.8** | $ 25.7 | **$ 44.5** | $ 7.6 | $ 18.5 |
| (Gain) loss on derivative financial instruments | **$ (0.4)** | $ 1.0 | **$ 0.6** | $ 2.0 | $ 1.5 |
| Foreign exchange loss on long-term debt | **$ -** | $ - | **$ -** | $ 3.4 | $ 5.4 |
| Change in substantively enacted tax rate | **$ -** | $ - | **$ -** | $ 2.4 | $ 2.4 |
| Net impact of above items | **$ (0.4)** | $ 1.0 | **$ 0.6** | $ 7.8 | $ 9.3 |
| **Adjusted net income** | **$ 18.4** | $ 26.7 | **$ 45.1** | $ 15.4 | $ 27.8 |
| **Net income per share (EPS), as reported** | **$ 0.27** | $ 0.36 | **$ 0.63** | $ 0.11 | $ 0.26 |
| Net impact of above items per share[4] | **$ (0.01)** | $ 0.01 | **$ 0.01** | $ 0.11 | $ 0.13 |
| **Adjusted net income per share[4]** | **$ 0.26** | $ 0.37 | **$ 0.64** | $ 0.22 | $ 0.39 |

[4] The year-to-date net impact of the adjusting items per share and adjusted net income per share does not equal the sum of the quarterly per share amounts due to rounding.

The Company reported operating income of $29.6 million for the second quarter of 2014, a decrease of $6.8 million from operating income of $36.4 million for the first quarter of 2014, as the impact of pulp and paper maintenance outages and higher fibre costs more than offset higher pulp and paper shipments. In addition, despite slight increases in the average Northern Bleached Softwood Kraft ("NBSK") pulp prices to North America and Europe, pulp unit sales realizations experienced a small decrease compared to the previous quarter due to a combination of weaker prices to China, a slightly stronger Canadian dollar and a higher proportion of shipments to lower-margin markets, including Asia, mostly tied to constraints in the previous quarter due to the Vancouver Port truckers' strike.

Global softwood pulp markets were steady through the second quarter of 2014. Softwood pulp demand was solid across all regions and global softwood pulp producer inventory levels tightened through the quarter, decreasing 3 days from the end of March 2014 to 25 days' supply in June 2014, partly reflecting supply constraints due to seasonal maintenance downtime (market conditions are generally considered balanced when inventories are in the 27-30 days of supply range). The North American NBSK pulp list price was stable over the quarter averaging US$1,030 per tonne, up US$13 per tonne, or 1%, compared to the first quarter of 2014. Discount levels were consistent with the previous quarter. The NBSK pulp list price to Europe also remained largely unchanged, averaging US$925 per tonne, up US$5 per tonne from the previous quarter, while the average NBSK pulp list price to China was down US$27 per tonne, or 4%, to US$730 per tonne.

Pulp shipments were up 11% from the previous quarter, largely attributable to improved transportation performance following the challenges experienced in the prior quarter. Pulp production levels were down 8% from the previous quarter principally related to the maintenance outages at the Intercontinental and Prince George Pulp Mills, which reduced market pulp production by 18,000 tonnes. Pulp unit manufacturing costs were up moderately compared to the previous quarter, mostly due to the aforementioned maintenance outages and increased fibre costs, partially offset by seasonally lower energy costs. The higher unit fibre costs reflected higher delivered sawmill residual and whole log chip costs and seasonal factors.

The Company's paper segment's operating income was down $0.7 million from the previous quarter, with the impact of a maintenance outage of the Prince George Kraft paper machine partially offset by higher shipment levels reflecting the improved transportation performance.

Compared to the second quarter of 2013, operating income was up $10.1 million, reflecting improved sales realizations for pulp and paper products coupled with higher energy revenue, all of which were partially offset by higher unit manufacturing costs. The higher sales realizations were principally driven by increased market pulp prices to all regions and a 6 cent, or 6% weaker Canadian dollar compared to the US dollar. The higher unit manufacturing costs reflected market-driven increases in fibre costs, higher energy costs and the impact of reduced production levels in the current quarter. Solid gains in energy revenue were principally due to the upgrades to the Northwood Pulp Mill turbines completed earlier in 2014.

## OPERATING RESULTS BY BUSINESS SEGMENT

### Pulp

**Selected Financial Information and Statistics – Pulp**

| (millions of Canadian dollars unless otherwise noted) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| Sales | **$ 207.8** | $ 190.7 | **$ 398.5** | $ 187.7 | $ 368.1 |
| Operating income before amortization | **$ 43.2** | $ 50.1 | **$ 93.3** | $ 33.4 | $ 66.7 |
| Operating income | **$ 28.8** | $ 35.0 | **$ 63.8** | $ 15.4 | $ 30.8 |
| Average pulp price delivered to U.S. – US$[5] | **$ 1,030** | $ 1,017 | **$ 1,023** | $ 937 | $ 917 |
| Average price in Cdn$ | **$ 1,123** | $ 1,122 | **$ 1,122** | $ 959 | $ 932 |
| Production – pulp (000 mt) | **237.7** | 258.7 | **496.4** | 250.0 | 514.5 |
| Shipments – pulp (000 mt) | **246.9** | 222.4 | **469.3** | 255.0 | 512.9 |
| Marketed on behalf of Canfor | **67.5** | 33.5 | **101.0** | 52.8 | 103.1 |

[5] Per tonne, NBSK pulp list price delivered to U.S. (Resource Information Systems, Inc.).

Overview

Operating income for the pulp segment was $28.8 million for the second quarter of 2014, down $6.2 million from the previous quarter and up $13.4 million from the second quarter of 2013.

Increased shipments in the current quarter reflected the release of inventories built in the first quarter of 2014 as a result of the transportation related challenges. While prices to North America and Europe held up well during the period, a combination of lower prices to China, a slightly stronger Canadian dollar compared to the US dollar, and a higher proportion of shipments to Asia resulted in a small decrease in the average unit sales realizations. Results in the current quarter were also impacted by maintenance outages at the Intercontinental and Prince George Pulp Mills and, to a lesser extent, operational challenges encountered following the outages, both of which contributed to lower production levels in the current quarter. Increased unit manufacturing costs in the current quarter were largely attributable to higher delivered fibre costs, which reflected market and seasonal factors, as well as increased freight costs, coupled with higher costs primarily driven by the maintenance outages and the lower production levels.

Compared to the second quarter of 2013, improved unit sales realizations, reflecting strong gains in NBSK pulp prices across all regions coupled with the benefit of a 6% weaker Canadian dollar, more than offset slightly lower shipments. Unit manufacturing costs were up compared to the same period in 2013, principally as the result of higher fibre (linked to NBSK pulp sales realizations) and energy costs and the unfavourable impact to unit costs of the reduced production levels, reflecting operational challenges encountered following the maintenance outages in the current quarter. Increased energy revenue resulting from the recent turbine generator upgrades also contributed to the higher quarter-over-quarter earnings.

Markets

Global softwood pulp markets were steady through the second quarter of 2014. Softwood pulp demand was solid across all regions and global softwood pulp producer inventory levels tightened through the quarter, decreasing 3 days from the end of March 2014 to 25 days' supply in June 2014[6], partly reflecting supply constraints due to seasonal maintenance downtime. Market conditions are generally considered balanced when inventories are in the 27-30 days of supply range.

Global shipments of bleached softwood kraft pulp improved modestly in the second quarter in part reflecting efforts to clear the inventory backlog created by transportation challenges experienced in the first quarter of 2014. However, global shipments of bleached softwood kraft pulp were relatively unchanged for the first half of 2014 when compared to the same period in 2013[7], due in part to the transportation challenges experienced in North America in the first quarter of 2014.

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

Sales

The Company's pulp shipments in the second quarter of 2014 were 246,900 tonnes, an increase of 24,500 tonnes, or 11%, from the previous quarter, and down 8,100 tonnes, or 3%, from the same period in 2013. Increased shipments compared to the previous quarter largely reflected the aforementioned improved transportation performance. Shipments to Asia were up relative to both comparable periods, with the increase relative to the immediately preceding quarter reflecting both the truckers' strike at the Vancouver Port as well as the traditional Chinese Lunar New Year Holiday in the previous quarter. Reduced shipments compared to the same period in 2013 included the impact of the maintenance outages in the current quarter, while the second quarter of 2013 also included a drawdown in inventory levels.

Global softwood pulp markets were steady through the current quarter, with the average North American NBSK pulp list price holding for the quarter at an almost three-year high of US$1,030 per tonne, up US$13 per tonne, or 1%, compared to the first quarter of 2014, in part reflecting the spring maintenance period offset slightly by the release of inventories built due to the transportation challenges experienced in the previous quarter. Discount levels were consistent with the previous quarter. The NBSK pulp list price to Europe also remained largely unchanged, averaging US$925 per tonne, up US$5 per tonne from the previous quarter, while the average NBSK pulp list price to China saw a modest decline, down US$27 per tonne, or 4%, to US$730 per tonne. Current quarter sales realizations were down slightly compared to the previous quarter, mainly reflecting the lower pulp prices to China, the 1% stronger Canadian dollar and increased shipments to lower-margin markets, particularly Asia. Current quarter sales included a modest increase in energy output resulting from the recently commissioned turbine upgrades at the Northwood Pulp Mill.

Compared to the second quarter of 2013, pulp sales realizations continued to see strong gains as a result of increases in average pulp list prices in all regions and the 6% weaker Canadian dollar. The North American NBSK pulp list price increased US$93 per tonne, or 10%. NBSK pulp list prices to China and Europe also experienced gains, up 4% and 8%, respectively, from the same period in 2013. These gains were partly offset by increased discounts in North American markets through the second half of 2013 and increased volumes to lower-margin regions, principally Asia. Energy revenue also saw solid gains compared to the second quarter of 2013, principally due to the aforementioned upgrades to the Northwood Pulp Mill turbines completed earlier in 2014.

Operations

Pulp production in the current quarter was 237,700 tonnes, down 21,000 tonnes, or 8%, from the previous quarter, and down 12,300 tonnes, or 5%, from the second quarter of 2013. Production in the current quarter reflected maintenance outages at the Intercontinental and Prince George Pulp Mills, which reduced market pulp production by 18,000 tonnes. In the comparative second quarter of 2013, production levels included maintenance outages at the Northwood and Intercontinental Pulp Mills, which reduced market pulp production by a similar level. Operating rates in the current quarter were lower than both comparable periods as a result of several operational challenges encountered following the maintenance outages.

Pulp unit manufacturing costs were up moderately compared to the previous quarter, reflecting higher fibre costs and the maintenance outages in the quarter. The increased fibre costs compared to the first quarter of 2014 reflected higher prices for sawmill residual and whole log chips, seasonal pricing adjustments and higher freight costs, all of which were partially offset by a lower proportion of the higher-cost whole log chips. Somewhat mitigating these factors were seasonally lower energy costs and usage in the current quarter.

Compared to the second quarter of 2013, unit manufacturing costs were higher primarily driven by increased fibre costs, largely attributable to market-driven increases to sawmill residual chip and whole log chip prices and higher freight costs, offset slightly by a lower proportion of the higher-cost whole log chips. Also contributing to higher unit manufacturing costs compared to the same period in 2013 were lower production levels as well as higher natural gas prices and usage, with the higher usage related to maintenance work performed in the current quarter.

## Paper

**Selected Financial Information and Statistics – Paper**

| (millions of Canadian dollars unless otherwise noted) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| Sales | **$ 44.5** | $ 34.8 | **$ 79.3** | $ 39.7 | $ 75.8 |
| Operating income before amortization | **$ 4.6** | $ 5.4 | **$ 10.0** | $ 8.0 | $ 14.9 |
| Operating income | **$ 3.8** | $ 4.5 | **$ 8.3** | $ 7.1 | $ 13.0 |
| Production – paper (000 mt) | **35.4** | 36.7 | **72.1** | 35.3 | 70.1 |
| Shipments – paper (000 mt) | **39.7** | 31.3 | **71.0** | 37.2 | 72.2 |

Overview

Operating income for the paper segment was $3.8 million for the second quarter of 2014, down $0.7 million from the first quarter of 2014 and down $3.3 million from the second quarter of 2013. The current quarter results included the impact of a maintenance outage at the Company's paper machine as well as increased shipments following the resolution of the Vancouver Port truckers' strike. The decrease in earnings compared to the previous quarter principally resulted from increased unit manufacturing costs reflecting the impact of the maintenance outage, which more than offset a modest improvement in unit sales realizations and higher shipments.

Compared to the second quarter of 2013, lower operating earnings reflected an increase in unit manufacturing costs related to higher slush pulp prices, which are tied to pulp sales realizations, partly offset by improved unit sales realizations and higher shipment levels.

Markets

Global kraft paper market demand was steady through the second quarter of 2014. Order files for sales to offshore markets were strong, while North American demand remained solid throughout the quarter, as end users ran at full capacity and maintained full order files.

Sales

The Company's paper shipments in the second quarter of 2014 were 39,700 tonnes, up 8,400 tonnes, or 27%, from the previous quarter and up 2,500 tonnes, or 7%, from the second quarter of 2013. Compared to the first quarter of 2014, increased shipments largely reflected a drawdown to normal inventory levels with improved transportation performance following the challenges in the previous quarter. Prime bleached shipments, which attract higher prices, were up 6% from the first quarter of 2014 and up 3% from the second quarter of 2013.

Current quarter unit sales realizations for paper products were in line with the first quarter of 2014, with increased prime bleached product sales offset by the slightly stronger Canadian dollar and increased shipments to lower-margin regions. Compared to the same period in 2013, unit sales realizations showed a modest improvement, mainly due to the weaker Canadian dollar and to a lesser extent, increased prime bleached product sales.

Operations

Paper production in the second quarter of 2014 was 35,400 tonnes, down 1,300 tonnes, or 4%, from the previous quarter and in line with the second quarter of 2013. The current quarter production reflected a maintenance outage at the Company's paper machine in May 2014 as well as improved operating rates. The paper machine set a quarterly production record in the current quarter, surpassing the recent record achieved in the first quarter of 2013.

Paper unit manufacturing costs increased compared to the first quarter of 2014 principally as a result of lower production volumes as well as higher costs related to the outage. Further contributing to increased manufacturing costs was the drawdown of higher cost inventories to more normal levels during the quarter.

Compared to the second quarter of 2013, higher unit manufacturing costs reflected market-driven increases in slush pulp costs, the impact of the maintenance outage in the current quarter and timing of spending on operating supplies.

**Unallocated Items**

**Selected Financial Information**

| (millions of Canadian dollars) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| Corporate costs | **$ (3.0)** | $ (3.1) | **$ (6.1)** | $ (3.0) | $ (5.3) |
| Finance expense, net | **$ (1.3)** | $ (1.5) | **$ (2.8)** | $ (2.5) | $ (5.6) |
| Foreign exchange loss on long-term debt | **$ -** | $ - | **$ -** | $ (3.9) | $ (6.2) |
| Gain (loss) on derivative financial instruments | **$ 0.6** | $ (1.4) | **$ (0.8)** | $ (2.6) | $ (1.9) |
| Other income (expense), net | **$ (3.7)** | $ 0.9 | **$ (2.8)** | $ 3.8 | $ 4.5 |

Corporate costs of $3.0 million for the second quarter of 2014 were in line with both comparative periods.

Net finance expense for the second quarter of 2014 was $1.3 million, broadly in line with the first quarter of 2014 and down $1.2 million from the second quarter of 2013. The decrease from the same quarter in 2013 reflected lower debt levels in the current quarter coupled with lower employee future benefit net interest costs, due in part to the improved financial position of the Company's largest defined benefit plan.

The Company uses a variety of derivative financial instruments as partial economic hedges against unfavourable changes in foreign exchange rates, energy costs, interest rates and pulp prices. For the second quarter of 2014, the Company recorded a net gain of $0.6 million reflecting unrealized gains on US dollar foreign exchange collars as a result of the strengthening of the Canadian dollar through the quarter, as well as unrealized losses on pulp futures as a result of improved NBSK pulp list prices through the quarter.

Other expense, net for the second quarter of 2014 of $3.7 million was mostly comprised of unfavourable exchange movements on US dollar denominated cash, receivables and payables, resulting from the strengthening of the Canadian dollar through June.

### Other Comprehensive Income (Loss)

In the second quarter of 2014, the Company recorded an after-tax loss to the Statements of Other Comprehensive Income (Loss) of $1.8 million in relation to changes in the valuation of the Company's employee future benefit plans. During the second quarter of 2014, an actuarial funding valuation was completed for the Company's largest employee future benefit plan resulting in revisions to actuarial assumptions as well as adjustments for plan member experience. Based on completion of the actuarial funding valuation, Canfor's overall funded position on a solvency basis has improved and future pension funding requirements will decrease. The Company's largest pension plan is now 100% funded on a solvency basis. On an accounting basis, as at June 30, 2014, the Company's largest pension plan was in a net asset position while the Company's other employee future benefit plans were in net liability positions.

The defined benefit actuarial loss recorded in the second quarter of 2014 reflects a lower discount rate used to value the net retirement benefit obligations, as well as the actuarial assumption and experience adjustments, offset in part by a modest return on plan assets. In the previous quarter, a loss of $6.8 million (after-tax) was recorded, while an after-tax gain of $6.8 million was recorded in the second quarter of 2013.

## SUMMARY OF FINANCIAL POSITION

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

| (millions of Canadian dollars, except for ratios) | Q2 2014 | Q1 2014 | YTD 2014 | Q2 2013 | YTD 2013 |
|---|---|---|---|---|---|
| Increase (decrease) in cash and cash equivalents | **$ 21.3** | $ 3.4 | **$ 24.7** | $ 28.4 | $ 46.1 |
| Operating activities | **$ 51.6** | $ 23.9 | **$ 75.5** | $ 44.6 | $ 72.9 |
| Financing activities | **$ (10.1)** | $ (10.5) | **$ (20.6)** | $ (8.4) | $ (12.2) |
| Investing activities | **$ (20.2)** | $ (10.0) | **$ (30.2)** | $ (7.8) | $ (14.6) |
| Ratio of current assets to current liabilities | | | **2.1 : 1** | | 1.2 : 1 |
| Net debt to capitalization | | | **2.5%** | | 14.9% |
| ROIC – Consolidated period-to-date | **4.0%** | **5.8%** | **9.8%** | **3.6%** | 6.6% |

## Changes in Financial Position

Cash generated from operating activities was $51.6 million in the second quarter of 2014, up $27.7 million from the previous quarter, with a decrease in non-cash working capital in the current quarter more than offsetting lower cash earnings. The decrease in non-cash working capital balances principally reflected the timing of payments related to the aforementioned maintenance outages and drawdown in pulp inventories, partially offset by higher trade accounts receivable balances reflecting the higher pulp shipments through the second quarter of 2014. Compared to the second quarter of 2013, cash generated from operating activities increased $7.0 million principally due to the size of the reduction in pulp inventories in the current period.

Cash used for financing activities was $10.1 million in the second quarter of 2014, in line with the previous quarter and up $1.7 million from the second quarter of 2013. Cash flows in the current period included a $4.5 million dividend (6.25 cents per share), up from $3.5 million (5 cents per share) in the previous quarter and $3.6 million (5 cents per share) in the second quarter of 2013. Finance expenses paid in the second quarter at $0.6 million were broadly in line with the first quarter of 2014 and down from $3.8 million paid in the second of 2013 reflecting lower debt levels as a result of the repayment of the Company's $110 million 6.41% interest rate debt in 2013. CPPI paid $5.0 million against its operating loan facility in the second quarter of 2014 and had no amounts drawn on the facility at the end of the quarter.

Cash used for investing activities of $20.2 million in the current quarter primarily related to the Intercontinental Pulp Mill's turbine upgrade and maintenance capital related to the aforementioned maintenance outages during the quarter. The Company anticipates that it will complete the upgrades to the Intercontinental Pulp Mill turbine and commence selling power under an Electricity Purchase Agreement early in 2015.

## Liquidity and Financial Requirements

At June 30, 2014, CPPI had cash of $38.2 million and operating loan facilities of $130.0 million which were unused, except for $12.2 million reserved for several standby letters of credit related to energy sales agreements. Total available undrawn operating loans were $117.8 million.

CPPI has $50.0 million of floating interest rate term debt, repayable in November 2018.

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

On March 5, 2014, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 3,550,367 common shares or approximately 5% of its issued and outstanding common shares as of February 28, 2014. The renewed normal course issuer bid is set to expire on March 4, 2015. There were no shares purchased by the Company during the second quarter of 2014.

## Dividends

On July 23, 2014, the Board of Directors declared a quarterly dividend of $0.0625 per share with a declaration date of July 23, 2014, payable on August 12, 2014, to the shareholders of record on August 5, 2014.

# OUTLOOK

## Pulp

NBSK pulp markets are steady heading into the seasonally slower third quarter of 2014. For the month of July 2014, the Company announced NBSK pulp list prices of US$1,030 per tonne in North America and US$730 per tonne in China, both unchanged from June 2014. A risk of price weakness remains for the second half of 2014 due in part to reduced global consumption during the historically slower summer months and new hardwood pulp capacity projected to flow into markets.

Early in July, the Company's operations experienced some disruptions which impacted production by approximately 10,000 tonnes; the mills have now returned to normal operating rates. A maintenance outage originally planned at the Northwood Pulp Mill in the third quarter of 2014 has been deferred to the fourth quarter of 2014 and is projected to reduce production by 10,000 tonnes.

**Paper**

Paper markets are stable heading into the third quarter of 2014 with solid order files and demand. There is some risk that new bleached capacity in Europe may put pressure on prices. Price increases announced in North America were fully implemented in the second quarter of 2014.

## OUTSTANDING SHARES

At July 23, 2014, there were 71,007,341 common shares outstanding.

## CRITICAL ACCOUNTING ESTIMATES

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

## ACCOUNTING STANDARDS ISSUED AND NOT APPLIED

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 has been deferred from the original date of January 1, 2015 and is currently under review by the IASB.

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2017. The Company is still in the process of assessing the impact, if any, on the financial statements of this new standard.

Further details of the new accounting Standards and potential impact on CPPI can be found in the Company's Annual Report for the year ended December 31, 2013.

## INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended June 30, 2014, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

## RISKS AND UNCERTAINTIES

A comprehensive discussion of risks and uncertainties is included in the Company's 2013 annual statutory reports which are available on www.canforpulp.com or www.sedar.com.

## SELECTED QUARTERLY FINANCIAL INFORMATION

| | Q2 2014 | Q1 2014 | Q4 2013 | Q3 2013 | Q2 2013 | Q1 2013 | Q4 2012 | Q3 2012 |
|---|---|---|---|---|---|---|---|---|
| **Sales and income** (millions of Canadian dollars) | | | | | | | | |
| Sales | **$ 252.5** | $ 226.4 | $ 245.6 | $ 196.1 | $ 227.6 | $ 217.5 | $ 201.9 | $ 177.7 |
| Operating income (loss) | **$ 29.6** | $ 36.4 | $ 24.0 | $ 11.3 | $ 19.5 | $ 19.0 | $ 12.1 | $ (8.3) |
| Net income (loss) | **$ 18.8** | $ 25.7 | $ 14.2 | $ 9.1 | $ 7.6 | $ 10.9 | $ 5.4 | $ (5.0) |
| **Per common share** (Canadian dollars) | | | | | | | | |
| Net income (loss) – basic and diluted | **$ 0.27** | $ 0.36 | $ 0.20 | $ 0.13 | $ 0.11 | $ 0.15 | $ 0.08 | $ (0.07) |
| Book value[8] | **$ 6.56** | $ 6.39 | $ 6.17 | $ 5.79 | $ 5.67 | $ 5.53 | $ 5.42 | $ 5.37 |
| Dividends declared | **$ 0.0625** | $ 0.0625 | $ 0.0500 | $ 0.0500 | $ 0.0500 | $ 0.0500 | $ 0.0500 | $ - |
| **Statistics** | | | | | | | | |
| Pulp shipments (000 mt) | **246.9** | 222.4 | 273.3 | 212.2 | 255.0 | 257.9 | 246.6 | 214.4 |
| Paper shipments (000 mt) | **39.7** | 31.3 | 31.1 | 35.5 | 37.2 | 35.0 | 32.0 | 30.6 |
| Average exchange rate – US$/Cdn$ | **$ 0.917** | $ 0.906 | $ 0.953 | $ 0.963 | $ 0.977 | $ 0.991 | $ 1.009 | $ 1.005 |
| Average NBSK pulp list price delivered to U.S. (US$) | **$ 1,030** | $ 1,017 | $ 983 | $ 947 | $ 937 | $ 897 | $ 863 | $ 853 |

[8] Book value per common share is equal to shareholders' equity at the end of the period, divided by the number of common shares outstanding at the end of 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 operating income before amortization are primarily impacted by: sales revenue; freight costs; fluctuations of fibre, chemical and energy prices; level of spending and timing of maintenance downtime; and production curtailments. Net income is also impacted by fluctuations in Canadian dollar exchange rates, the revaluation to the period end rate of US dollar denominated working capital balances and long-term debt, and revaluation of outstanding natural gas swaps and US dollar forward contracts.

Other material factors that impact the comparability of the quarters are noted below:

| After-tax impact (millions of Canadian dollars, except for per share amounts) | **Q2 2014** | Q1 2014 | Q4 2013 | Q3 2013 | Q2 2013 | Q1 2013 | Q4 2012 | Q3 2012 |
|---|---|---|---|---|---|---|---|---|
| **Net income (loss), as reported** | **$ 18.8** | $ 25.7 | $ 14.2 | $ 9.1 | $ 7.6 | $ 10.9 | $ 5.4 | $ (5.0) |
| (Gain) loss on derivative financial instruments | **$ (0.4)** | $ 1.0 | $ 0.1 | $ (1.5) | $ 2.0 | $ (0.5) | $ 0.1 | $ (1.4) |
| Foreign exchange (gain) loss on long-term debt | **$ -** | $ - | $ 3.0 | $ (2.0) | $ 3.4 | $ 2.0 | $ 1.1 | $ (3.4) |
| Change in substantively enacted tax rate | **$ -** | $ - | $ - | $ - | $ 2.4 | $ - | $ - | $ - |
| Net gain on post retirement plan amendments | **$ -** | $ - | $ - | $ - | $ - | $ - | $ (4.0) | $ - |
| Restructuring charges for management changes | **$ -** | $ - | $ - | $ - | $ - | $ - | $ - | $ 1.3 |
| Net impact of above items | **$ (0.4)** | $ 1.0 | $ 3.1 | $ (3.5) | $ 7.8 | $ 1.5 | $ (2.8) | $ (3.5) |
| **Adjusted net income (loss)** | **$ 18.4** | $ 26.7 | $ 17.3 | $ 5.6 | $ 15.4 | $ 12.4 | $ 2.6 | $ (8.5) |
| **Net income (loss) per share (EPS), as reported** | **$ 0.27** | $ 0.36 | $ 0.20 | $ 0.13 | $ 0.11 | $ 0.15 | $ 0.08 | $ (0.07) |
| Net impact of above items per share | **$ (0.01)** | $ 0.01 | $ 0.04 | $ (0.05) | $ 0.11 | $ 0.02 | $ (0.04) | $ (0.05) |
| **Adjusted net income (loss) per share** | **$ 0.26** | $ 0.37 | $ 0.24 | $ 0.08 | $ 0.22 | $ 0.17 | $ 0.04 | $ (0.12) |

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

| (millions of Canadian dollars, unaudited) | | **As at June 30, 2014** | | As at December 31, 2013 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | **$** | **38.2** | $ | 13.5 |
| Accounts receivable - Trade | | **77.3** | | 71.0 |
| - Other | | **10.0** | | 10.3 |
| Inventories (Note 2) | | **146.0** | | 128.0 |
| Prepaid expenses and other assets | | **2.5** | | 7.2 |
| Total current assets | | **274.0** | | 230.0 |
| **Property, plant and equipment** | | **531.4** | | 528.1 |
| **Retirement benefit surplus** (Note 4) | | **5.1** | | 8.2 |
| **Other long-term assets** | | **0.7** | | 2.3 |
| **Total assets** | **$** | **811.2** | $ | 768.6 |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Operating loans (Note 3) | **$** | **-** | $ | 10.6 |
| Accounts payable and accrued liabilities | | **133.0** | | 118.4 |
| Total current liabilities | | **133.0** | | 129.0 |
| **Long-term debt** | | **50.0** | | 50.0 |
| **Retirement benefit obligations** (Note 4) | | **84.5** | | 75.8 |
| **Other long-term provisions** | | **3.6** | | 3.0 |
| **Deferred income taxes, net** | | **74.2** | | 72.8 |
| **Total liabilities** | **$** | **345.3** | $ | 330.6 |
| **EQUITY** | | | | |
| Share capital | **$** | **523.4** | $ | 523.4 |
| Retained earnings (deficit) | | **(57.5)** | | (85.4) |
| **Total equity** | **$** | **465.9** | $ | 438.0 |
| **Total liabilities and equity** | **$** | **811.2** | $ | 768.6 |

**Subsequent Event** (Note 11)

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

APPROVED BY THE BOARD

Director, S.E. Bracken-Horrocks

Director, M.J. Korenberg

## Canfor Pulp Products Inc.
## Condensed Consolidated Statements of Income

| (millions of Canadian dollars, except per share data, unaudited) | 3 months ended June 30, **2014** | 3 months ended June 30, 2013 | 6 months ended June 30, **2014** | 6 months ended June 30, 2013 |
|---|---|---|---|---|
| **Sales** | **$ 252.5** | $ 227.6 | **$ 478.9** | $ 445.1 |
| **Costs and expenses** | | | | |
| Manufacturing and product costs | **166.4** | 151.7 | **304.9** | 295.0 |
| Freight and other distribution costs | **33.9** | 31.9 | **62.8** | 62.8 |
| Amortization | **15.2** | 19.0 | **31.2** | 37.9 |
| Selling and administration costs | **7.4** | 5.5 | **14.0** | 10.9 |
| | **222.9** | 208.1 | **412.9** | 406.6 |
| **Operating income** | **29.6** | 19.5 | **66.0** | 38.5 |
| Finance expense, net | **(1.3)** | (2.5) | **(2.8)** | (5.6) |
| Foreign exchange loss on long-term debt | **-** | (3.9) | **-** | (6.2) |
| Gain (loss) on derivative financial instruments (Note 5) | **0.6** | (2.6) | **(0.8)** | (1.9) |
| Other income (expense), net | **(3.7)** | 3.8 | **(2.8)** | 4.5 |
| Net income before income taxes | **25.2** | 14.3 | **59.6** | 29.3 |
| Income tax expense (Note 6) | **(6.4)** | (6.7) | **(15.1)** | (10.8) |
| **Net income** | **$ 18.8** | $ 7.6 | **$ 44.5** | $ 18.5 |
| **Net income per common share:** (in Canadian dollars) | | | | |
| Attributable to equity shareholders of the Company | | | | |
| - Basic and diluted (Note 7) | **$ 0.27** | $ 0.11 | **$ 0.63** | $ 0.26 |

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

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

| (millions of Canadian dollars, unaudited) | 3 months ended June 30, **2014** | 2013 | 6 months ended June 30, **2014** | 2013 |
|---|---|---|---|---|
| **Net income** | **$ 18.8** | $ 7.6 | **$ 44.5** | $ 18.5 |
| **Other comprehensive income (loss)** | | | | |
| Items that will not be recycled through net income: | | | | |
| Defined benefit plan actuarial gains (losses) (Note 4) | **(2.4)** | 9.1 | **(11.6)** | 9.4 |
| Income tax recovery (expense) on defined benefit plan actuarial gains (losses) (Note 6) | **0.6** | (2.3) | **3.0** | (2.4) |
| Other comprehensive income (loss), net of tax | **(1.8)** | 6.8 | **(8.6)** | 7.0 |
| **Total comprehensive income** | **$ 17.0** | $ 14.4 | **$ 35.9** | $ 25.5 |

## Condensed Consolidated Statements of Changes in Equity

| (millions of Canadian dollars, unaudited) | 3 months ended June 30, **2014** | 2013 | 6 months ended June 30, **2014** | 2013 |
|---|---|---|---|---|
| **Share capital** | | | | |
| Balance at beginning of period | **$ 523.4** | $ 525.3 | **$ 523.4** | $ 525.3 |
| Share purchases (Note 7) | **-** | (1.2) | **-** | (1.2) |
| Balance at end of period | **$ 523.4** | $ 524.1 | **$ 523.4** | $ 524.1 |
| **Retained earnings (deficit)** | | | | |
| Balance at beginning of period | **$ (70.0)** | $ (131.2) | **$ (85.4)** | $ (138.7) |
| Net income | **18.8** | 7.6 | **44.5** | 18.5 |
| Defined benefit plan actuarial gains (losses), net of tax | **(1.8)** | 6.8 | **(8.6)** | 7.0 |
| Dividends declared | **(4.5)** | (3.6) | **(8.0)** | (7.2) |
| Share purchases (Note 7) | **-** | (0.3) | **-** | (0.3) |
| Balance at end of period | **$ (57.5)** | $ (120.7) | **$ (57.5)** | $ (120.7) |
| **Total equity** | **$ 465.9** | $ 403.4 | **$ 465.9** | $ 403.4 |

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

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

| (millions of Canadian dollars, unaudited) | 3 months ended June 30, 2014 | 3 months ended June 30, 2013 | 6 months ended June 30, 2014 | 6 months ended June 30, 2013 |
|---|---|---|---|---|
| **Cash generated from (used in):** | | | | |
| **Operating activities** | | | | |
| Net income | **$ 18.8** | $ 7.6 | **$ 44.5** | $ 18.5 |
| Items not affecting cash: | | | | |
| Amortization | **15.2** | 19.0 | **31.2** | 37.9 |
| Income tax expense | **6.4** | 6.7 | **15.1** | 10.8 |
| Foreign exchange loss on long-term debt | **-** | 3.9 | **-** | 6.2 |
| Changes in mark-to-market value of derivative financial instruments | **(0.9)** | 2.6 | **0.3** | 2.0 |
| Employee future benefits | **1.2** | 1.3 | **2.4** | 2.7 |
| Net finance expense | **1.3** | 2.5 | **2.8** | 5.6 |
| Other, net | **1.5** | (2.0) | **3.1** | (3.8) |
| Defined benefit pension plan contributions | **(1.3)** | (2.5) | **(3.8)** | (5.3) |
| Income taxes paid, net | **(1.3)** | - | **(10.9)** | - |
| | **40.9** | 39.1 | **84.7** | 74.6 |
| Net change in non-cash working capital (Note 8) | **10.7** | 5.5 | **(9.2)** | (1.7) |
| | **51.6** | 44.6 | **75.5** | 72.9 |
| **Financing activities** | | | | |
| Change in operating bank loans | **(5.0)** | - | **(11.2)** | - |
| Finance expenses paid | **(0.6)** | (3.8) | **(1.4)** | (4.0) |
| Dividends paid | **(4.5)** | (3.6) | **(8.0)** | (7.2) |
| Share purchases (Note 7) | **-** | (1.0) | **-** | (1.0) |
| | **(10.1)** | (8.4) | **(20.6)** | (12.2) |
| **Investing activities** | | | | |
| Additions to property, plant and equipment, net | **(20.2)** | (7.9) | **(30.2)** | (14.8) |
| Other, net | **-** | 0.1 | **-** | 0.2 |
| | **(20.2)** | (7.8) | **(30.2)** | (14.6) |
| **Increase in cash and cash equivalents*** | **21.3** | 28.4 | **24.7** | 46.1 |
| Cash and cash equivalents at beginning of period* | **16.9** | 16.5 | **13.5** | (1.2) |
| **Cash and cash equivalents at end of period*** | **$ 38.2** | $ 44.9 | **$ 38.2** | 44.9 |

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

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

## 1. Basis of Preparation

These condensed consolidated interim financial statements (the "financial statements") have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*, and include the accounts of Canfor Pulp Products Inc. ("CPPI") and its subsidiary entities, hereinafter referred to as "CPPI" or "the Company". At June 30, 2014, Canfor Corporation ("Canfor") held a 50.4% interest in CPPI.

These financial statements do not include all of the disclosures required by International Financial Reporting Standards ("IFRS") for annual financial statements. Additional disclosures relevant to the understanding of these financial statements, including the accounting policies applied, can be found in the Company's Annual Report for the year ended December 31, 2013, available at www.canforpulp.com or www.sedar.com.

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

### *Accounting Standards Issued and Not Applied*

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 has been deferred from the original date of January 1, 2015 and is currently under review by the IASB.

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which will supersede IAS 18, *Revenue*, IAS 11, *Construction Contracts* and related interpretations. The new standard is effective for annual periods beginning on or after January 1, 2017. The Company is still in the process of assessing the impact, if any, on the financial statements of this new standard.

Further details of the new accounting Standards and potential impact on CPPI can be found in the Company's Annual Report for the year ended December 31, 2013.

## 2. Inventories

| (millions of Canadian dollars) | **As at June 30, 2014** | As at December 31, 2013 |
|---|---|---|
| Pulp | **$ 72.6** | $ 52.8 |
| Paper | **17.1** | 15.7 |
| Wood chips | **10.5** | 14.1 |
| Processing materials and supplies | **45.8** | 45.4 |
| | **$ 146.0** | $ 128.0 |

## 3. Operating Loans

### *Available Operating Loans*

| (millions of Canadian dollars) | **As at June 30, 2014** | As at December 31, 2013 |
|---|---|---|
| Available Operating Loans: | | |
| Operating loan facility | **$ 110.0** | $ 110.0 |
| Facility for letters of credit related to energy agreements | **20.0** | 20.0 |
| Total operating loans | **130.0** | 130.0 |
| Drawn | **-** | (10.6) |
| Energy letters of credit | **(12.2)** | (12.2) |
| Total available operating loans | **$ 117.8** | $ 107.2 |

The terms of the Company's operating loan facility include interest payable at floating rates that vary depending on the ratio of net debt to total capitalization, and is based on the lenders' Canadian prime rate, bankers acceptances, US dollar base rate or US dollar LIBOR rate, plus a margin. The facility has certain financial covenants that stipulate maximum net debt to total capitalization ratios and minimum net worth amounts based on shareholders' equity. The maturity date of this facility is January 31, 2018.

The Company has a separate facility with a maturity date of June 30, 2015 to cover energy-related letters of credit. At June 30, 2014, $9.4 million of energy-related letters of credit were covered under this facility with the balance of $2.8 million covered under the Company's general operating loan facility.

As at June 30, 2014 the Company was in compliance with all covenants relating to its operating loans.

## 4. Employee Future Benefits

For the three months ended June 30, 2014, a defined benefit actuarial loss of $2.4 million (before-tax) was recognized in other comprehensive income. During the second quarter of 2014, an actuarial funding valuation was completed for the Company's largest employee future benefit plan resulting in revisions to actuarial assumptions and adjustments for plan member experience. The defined benefit actuarial loss recorded in the second quarter of 2014 reflects a lower discount rate used to value the net retirement benefit obligations, as well as the actuarial assumption and experience adjustments, offset by a return on plan assets. For the six months ended June 30, 2014, a defined benefit actuarial loss of $11.6 million (before-tax) was recognized in other comprehensive income. For the three months ended June 30, 2013, an amount of $9.1 million (before-tax) was credited to other comprehensive income, and for the six months ended June 30, 2013, the gain was $9.4 million (before-tax).

For the Company's employee future benefit plans, a one percentage point increase in the discount rate used in calculating the actuarial estimate of future liabilities would decrease the accrued benefit obligation by an estimated $22.6 million.

The discount rate assumptions used to estimate the changes in net retirement benefit obligations were as follows:

| | |
|---|---|
| **Pension Benefit Plans** | |
| Discount rate | |
| June 30, 2014 | **4.30%** |
| March 31, 2014 | 4.40% |
| December 31, 2013 | 4.80% |
| June 30, 2013 | 4.60% |
| March 31, 2013 | 4.10% |
| December 31, 2012 | 4.20% |
| **Other Benefit Plans** | |
| Discount rate | |
| June 30, 2014 | **4.40%** |
| March 31, 2014 | 4.50% |
| December 31, 2013 | 4.90% |
| June 30, 2013 | 4.70% |
| March 31, 2013 | 4.30% |
| December 31, 2012 | 4.40% |

## 5. Financial Instruments

CPPI's cash and cash equivalents, accounts receivable, loans and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial recognition. At June 30, 2014, the fair value of the Company's long-term debt approximates its amortized cost of $50.0 million (December 31, 2013 - $50.0 million).

Derivative instruments are measured at fair value. IFRS 13, *Fair Value Measurement,* requires classification of financial instruments within a hierarchy that prioritizes the inputs to fair value measurement.

The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly;

Level 3 – Inputs that are not based on observable market data.

The Company uses a variety of derivative financial instruments to reduce its exposure to risks associated with fluctuations in foreign exchange rates, pulp prices, energy costs, and floating interest rates on long-term debt.

At June 30, 2014, the fair value of derivative financial instruments was a net liability of $0.4 million (December 31, 2013 – net liability of $0.1 million). The fair value of these financial instruments was determined based on prevailing market rates for instruments with similar characteristics.

The following table summarizes the gain (loss) on level 2 derivative financial instruments for the three and six month periods ended June 30, 2014 and 2013:

| | 3 months ended June 30, | | 6 months ended June 30, | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **2014** | 2013 | **2014** | 2013 |
| Foreign exchange collars and forward contracts | **$ 1.0** | $ (2.7) | **$ -** | $ (2.0) |
| Crude oil collars | **-** | - | **-** | 0.1 |
| Interest rate swaps | **-** | 0.1 | **(0.1)** | - |
| Pulp futures | **(0.4)** | - | **(0.7)** | - |
| Gain (loss) on derivative financial instruments | **$ 0.6** | $ (2.6) | **$ (0.8)** | $ (1.9) |

## 6. Income Taxes

| | 3 months ended June 30, | | 6 months ended June 30, | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **2014** | 2013 | **2014** | 2013 |
| Current | **$ (5.9)** | $ (6.4) | **$ (10.9)** | $ (11.7) |
| Deferred | **(0.5)** | (0.3) | **(4.2)** | 0.9 |
| Income tax expense | **$ (6.4)** | $ (6.7) | **$ (15.1)** | $ (10.8) |

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

| | 3 months ended June 30, | | 6 months ended June 30, | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **2014** | 2013 | **2014** | 2013 |
| Income tax expense at statutory rate 2014 – 26.0% (2013 – 25.75%)[1] | **$ (6.6)** | $ (3.7) | **$ (15.5)** | $ (7.5) |
| Add (deduct): | | | | |
| Entities with different income tax rates and other tax adjustments | **0.2** | (0.1) | **0.5** | (0.1) |
| Permanent difference from capital gains and other non-deductible items | **-** | (0.5) | **(0.1)** | (0.8) |
| Change in substantively enacted tax rate[1] | **-** | (2.4) | **-** | (2.4) |
| Income tax expense | **$ (6.4)** | $ (6.7) | **$ (15.1)** | $ (10.8) |

[1] In the second quarter of 2013, the British Columbia Provincial Government increased the corporate tax rate from 10% to 11%.

In addition to the amounts recorded to net income, a tax recovery of $0.6 million was recorded to other comprehensive income for the three month period ended June 30, 2014 (three months ended June 30, 2013 – expense of $2.3 million) in relation to the actuarial gains (losses) on defined benefit employee compensation plans. For the six month period ended June 30, 2014, a tax recovery of $3.0 million was recorded to other comprehensive income (six months ended June 30, 2013 – expense of $2.4 million).

## 7. Earnings per Share and Normal Course Issuer Bid

Basic net income per share is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the period.

| | 3 months ended June 30, | | 6 months ended June 30, | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Weighted average number of common shares | **71,007,341** | 71,252,370 | **71,007,341** | 71,261,032 |

On March 5, 2014, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 3,550,367 common shares or approximately 5% of its issued and outstanding common shares as of February 28, 2014. The renewed normal course issuer bid is set to expire on March 4, 2015. There were no shares purchased by the Company during the second quarter of 2014. As at July 23, 2014, there were 71,007,341 common shares outstanding.

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

| | 3 months ended June 30, | | 6 months ended June 30, | |
|---|---|---|---|---|
| (millions of Canadian dollars) | **2014** | 2013 | **2014** | 2013 |
| Accounts receivable | **$ (8.5)** | $ (2.9) | **$ (8.0)** | $ (17.0) |
| Inventories | **3.4** | (3.6) | **(18.0)** | (3.9) |
| Prepaid expenses and other assets | **0.8** | 4.3 | **3.1** | 5.5 |
| Accounts payable and accrued liabilities | **15.0** | 7.7 | **13.7** | 13.7 |
| Net decrease (increase) in non-cash working capital | **$ 10.7** | $ 5.5 | **$ (9.2)** | $ (1.7) |

## 9. Segment Information

The Company has two reportable segments which operate as separate business units and represent separate product lines.

Sales between pulp and paper segments are accounted for at prices that approximate fair value. These include sales of slush pulp from the pulp segment to the paper segment.

| (millions of Canadian dollars) | | Pulp | Paper | Unallocated | Elimination Adjustment | | Consolidated |
|---|---|---|---|---|---|---|---|
| **3 months ended June 30, 2014** | | | | | | | |
| **Sales to external customers** | **$** | **207.8** | **44.5** | **0.2** | **-** | **$** | **252.5** |
| **Sales to other segments** | **$** | **23.0** | **-** | **-** | **(23.0)** | **$** | **-** |
| **Operating income (loss)** | **$** | **28.8** | **3.8** | **(3.0)** | **-** | **$** | **29.6** |
| **Amortization** | **$** | **14.4** | **0.8** | **-** | **-** | **$** | **15.2** |
| **Capital expenditures[2]** | **$** | **19.9** | **0.3** | **-** | **-** | **$** | **20.2** |
| 3 months ended June 30, 2013 | | | | | | | |
| Sales to external customers | $ | 187.7 | 39.7 | 0.2 | - | $ | 227.6 |
| Sales to other segments | $ | 19.9 | - | - | (19.9) | $ | - |
| Operating income (loss) | $ | 15.4 | 7.1 | (3.0) | - | $ | 19.5 |
| Amortization | $ | 18.0 | 0.9 | 0.1 | - | $ | 19.0 |
| Capital expenditures[2] | $ | 7.8 | 0.1 | - | - | $ | 7.9 |
| **6 months ended June 30, 2014** | | | | | | | |
| **Sales to external customers** | **$** | **398.5** | **79.3** | **1.1** | **-** | **$** | **478.9** |
| **Sales to other segments** | **$** | **47.5** | **-** | **-** | **(47.5)** | **$** | **-** |
| **Operating income (loss)** | **$** | **63.8** | **8.3** | **(6.1)** | **-** | **$** | **66.0** |
| **Amortization** | **$** | **29.5** | **1.7** | **-** | **-** | **$** | **31.2** |
| **Capital expenditures[2]** | **$** | **29.8** | **0.4** | **-** | **-** | **$** | **30.2** |
| **Identifiable assets** | **$** | **695.2** | **60.6** | **55.4** | **-** | **$** | **811.2** |
| 6 months ended June 30, 2013 | | | | | | | |
| Sales to external customers | $ | 368.1 | 75.8 | 1.2 | - | $ | 445.1 |
| Sales to other segments | $ | 38.0 | - | - | (38.0) | $ | - |
| Operating income (loss) | $ | 30.8 | 13.0 | (5.3) | - | $ | 38.5 |
| Amortization | $ | 35.9 | 1.9 | 0.1 | - | $ | 37.9 |
| Capital expenditures[2] | $ | 14.4 | 0.3 | 0.1 | - | $ | 14.8 |
| Identifiable assets | $ | 681.0 | 66.9 | 58.4 | - | $ | 806.3 |

[2] Capital expenditures represent cash paid for capital assets during the periods net of capital expenditures that were partially financed by government grants.

## 10. Related Party Transactions

The Company relies on Canfor to provide approximately 58% (2013 – 62%) of its fibre supply as well as certain key business and administrative services. As a result of these relationships the Company considers its operations to be dependent on its ongoing relationship with Canfor. The transactions with Canfor are consistent with the transactions described in the December 31, 2013 audited consolidated financial statements of CPPI and are based on agreed upon amounts between the parties.

Transactions and payables to Canfor include purchases of wood chips, pulp and administrative services. These are summarized below:

| | 3 months ended June 30, | | | | 6 months ended June 30, | | |
|---|---|---|---|---|---|---|---|
| (millions of Canadian dollars) | | **2014** | | 2013 | | **2014** | 2013 |
| **Transactions** | | | | | | | |
| Purchase of wood chips and other | **$** | **32.0** | $ | 28.5 | **$** | **67.0** | $ 59.8 |

| (millions of Canadian dollars) | | **As at June 30, 2014** | | As at December 31, 2013 |
|---|---|---|---|---|
| **Balance Sheet** | | | | |
| Included in accounts payable and accrued liabilities: | **$** | **25.3** | $ | 18.9 |
| Included in trade and other accounts receivable: | **$** | **9.0** | $ | 9.0 |

## 11. Subsequent Event

On July 23, 2014, the Board of Directors declared a quarterly dividend of $0.0625 per share with a declaration date of July 23, 2014, payable on August 12, 2014, to shareholders of record on August 5, 2014.