

2016

CANFOR PULP PRODUCTS INC.
QUARTER THREE
FINANCIAL STATEMENTS

Canfor Pulp Products Inc.
Condensed Consolidated Balance Sheets

(millions of Canadian dollars, unaudited)	As at September 30, 2016	As at December 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	\$ 31.9	\$ 17.5
Accounts receivable - Trade	87.1	101.8
- Other	20.7	17.5
Inventories (Note 2)	154.0	163.8
Prepaid expenses	11.3	7.5
Total current assets	305.0	308.1
Property, plant and equipment	524.6	532.3
Other long-term assets (Note 11)	5.1	0.9
Total assets	\$ 834.7	\$ 841.3
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 125.9	\$ 144.2
Total current liabilities	125.9	144.2
Long-term debt	50.0	50.0
Retirement benefit obligations (Note 4)	112.5	93.0
Other long-term provisions	6.8	6.2
Deferred income taxes, net	63.0	68.2
Total liabilities	\$ 358.2	\$ 361.6
EQUITY		
Share capital	\$ 491.6	\$ 508.2
Retained earnings (deficit)	(15.3)	(28.5)
Accumulated other comprehensive income	0.2	-
Total equity	\$ 476.5	\$ 479.7
Total liabilities and equity	\$ 834.7	\$ 841.3

Subsequent Event (Note 13)

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

APPROVED BY THE BOARD

"S.E. Bracken-Horrocks"

Director, S.E. Bracken-Horrocks

"M.J. Korenberg"

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 September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Sales	\$ 291.6	\$ 294.1	\$ 844.1	\$ 843.9
Costs and expenses				
Manufacturing and product costs	195.2	186.2	573.4	548.8
Freight and other distribution costs	39.9	42.4	120.4	122.0
Amortization	19.0	16.4	54.6	47.6
Selling and administration costs	6.5	6.8	20.4	20.9
	260.6	251.8	768.8	739.3
Operating income	31.0	42.3	75.3	104.6
Finance expense, net	(1.6)	(1.7)	(4.7)	(4.3)
Loss on derivative financial instruments (Note 5)	-	(4.9)	-	(9.7)
Other income (expense), net	0.8	6.2	(5.3)	12.6
Net income before income taxes	30.2	41.9	65.3	103.2
Income tax expense (Note 6)	(7.8)	(10.7)	(17.6)	(26.3)
Net income	\$ 22.4	\$ 31.2	\$ 47.7	\$ 76.9
Net income per common share: (in Canadian dollars)				
Attributable to equity shareholders of the Company				
- Basic and diluted (Note 7)	\$ 0.34	\$ 0.45	\$ 0.70	\$ 1.09

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

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

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Net income	\$ 22.4	\$ 31.2	\$ 47.7	\$ 76.9
Other comprehensive income (loss)				
Items that will not be recycled through net income:				
Defined benefit pension plan actuarial gains (losses) (Note 4)	(1.5)	3.8	(19.0)	6.9
Income tax recovery (expense) on defined benefit pension plan actuarial gains (losses) (Note 6)	0.4	(1.0)	5.0	(1.8)
	(1.1)	2.8	(14.0)	5.1
Items that may be recycled through net income:				
Change in fair value of available-for-sale financial instruments, net of tax (Note 11)	0.2	-	0.2	-
Other comprehensive income (loss), net of tax	(0.9)	2.8	(13.8)	5.1
Total comprehensive income	\$ 21.5	\$ 34.0	\$ 33.9	\$ 82.0

Condensed Consolidated Statements of Changes in Equity

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Share capital				
Balance at beginning of period	\$ 491.6	\$ 517.5	\$ 508.2	\$ 522.1
Share purchases (Note 7)	-	(4.1)	(16.6)	(8.7)
Balance at end of period	\$ 491.6	\$ 513.4	\$ 491.6	\$ 513.4
Retained earnings (deficit)				
Balance at beginning of period	\$ (32.5)	\$ 2.3	\$ (28.5)	\$ (32.5)
Net income	22.4	31.2	47.7	76.9
Defined benefit pension plan actuarial gains (losses), net of tax	(1.1)	2.8	(14.0)	5.1
Dividends declared	(4.1)	(83.3)	(12.7)	(92.1)
Share purchases (Note 7)	-	(2.8)	(7.8)	(7.2)
Balance at end of period	\$ (15.3)	\$ (49.8)	\$ (15.3)	\$ (49.8)
Accumulated other comprehensive income				
Balance at beginning of period	\$ -	\$ -	\$ -	\$ -
Change in fair value of available-for-sale financial instruments, net of tax (Note 11)	0.2	-	0.2	-
Balance at end of period	\$ 0.2	\$ -	\$ 0.2	\$ -
Total equity	\$ 476.5	\$ 463.6	\$ 476.5	\$ 463.6

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

Canfor Pulp Products Inc.
Condensed Consolidated Statements of Cash Flows

	3 months ended September 30, 2016		9 months ended September 30, 2015	
(millions of Canadian dollars, unaudited)	2016	2015	2016	2015
Cash generated from (used in):				
Operating activities				
Net income	\$ 22.4	\$ 31.2	\$ 47.7	\$ 76.9
Items not affecting cash:				
Amortization	19.0	16.4	54.6	47.6
Income tax expense	7.8	10.7	17.6	26.3
Changes in mark-to-market value of derivative financial instruments	-	0.4	-	1.3
Employee future benefits	1.2	1.4	3.7	4.2
Finance expense, net	1.6	1.7	4.7	4.3
Other, net	0.2	(0.3)	(1.6)	(1.0)
Defined benefit pension plan contributions, net	(3.6)	(0.5)	(6.2)	(2.2)
Income taxes paid, net	(18.6)	(18.3)	(32.8)	(34.0)
	30.0	42.7	87.7	123.4
Net change in non-cash working capital (Note 8)	(3.9)	(10.5)	15.2	(21.1)
	26.1	32.2	102.9	102.3
Financing activities				
Finance expenses paid	(0.8)	(0.9)	(2.1)	(2.0)
Dividends paid	(4.1)	(83.3)	(12.7)	(92.1)
Share purchases (Note 7)	(0.3)	(6.7)	(24.7)	(15.7)
	(5.2)	(90.9)	(39.5)	(109.8)
Investing activities				
Additions to property, plant and equipment and intangible assets, net	(14.0)	(14.5)	(45.7)	(40.7)
Acquisition of Taylor pulp mill (Note 12)	-	-	-	(12.6)
Other, net	-	0.1	(3.3)	0.6
	(14.0)	(14.4)	(49.0)	(52.7)
Increase (decrease) in cash and cash equivalents*	6.9	(73.1)	14.4	(60.2)
Cash and cash equivalents at beginning of period*	25.0	89.7	17.5	76.8
Cash and cash equivalents at end of period*	\$ 31.9	\$ 16.6	\$ 31.9	\$ 16.6

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

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

Canfor Pulp Products Inc. Notes to the Condensed Consolidated Financial Statements

Three and nine months ended September 30, 2016 and 2015
(unaudited, millions of Canadian dollars unless otherwise noted)

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 October 26, 2016, Canfor Corporation ("Canfor") held a 53.6% 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, 2015, available at www.canfor.com or www.sedar.com.

These financial statements were authorized for issue by the Company's Board of Directors on October 26, 2016.

Accounting Standards Issued and Not Applied

In May 2014, the International Accounting Standards Board ("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, 2018. The Company is in the process of assessing the impact, if any, on the financial statements of this new standard.

In July 2014, the IASB issued IFRS 9, *Financial Instruments*. The required adoption date for IFRS 9 is January 1, 2018 and the Company is in the process of assessing the impact, if any, on the financial statements of this new standard.

In January 2016, the IASB issued IFRS 16, *Leases*, which will supersede IAS 17, *Leases* and related interpretations. The required adoption date for IFRS 16 is January 1, 2019 and the Company is in the process of assessing the impact, if any, on the financial statements of this new standard.

2. Inventories

(millions of Canadian dollars, unaudited)	As at September 30, 2016	As at December 31, 2015
Pulp	\$ 64.5	\$ 71.2
Paper	13.7	20.9
Wood chips and logs	24.4	21.9
Materials and supplies	51.4	49.8
	\$ 154.0	\$ 163.8

The above inventory balances are stated after inventory write-downs from cost to net realizable value. There were no inventory write-downs at September 30, 2016 (December 31, 2015 - \$0.5 million).

3. Operating Loans

Available Operating Loans

(millions of Canadian dollars, unaudited)	As at September 30, 2016	As at December 31, 2015
Operating loan facility	\$ 110.0	\$ 110.0
Facility for letters of credit	-	20.0
Total operating loan facility	110.0	130.0
Letters of credit	(9.1)	(13.0)
Total available operating loan facility	\$ 100.9	\$ 117.0

The terms of the Company's operating loan facility include interest payable at floating rates that vary depending on the ratio of 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 including a covenant based on maximum debt to total capitalization of the Company. In 2015, the maturity date of this facility was extended to January 31, 2019 and the minimum net worth financial covenant, which was based on shareholders' equity, was removed.

CPPI had a separate facility to cover letters of credit, which expired on June 30, 2016 and was not extended. At September 30, 2016, \$9.1 million of letters of credit outstanding are covered under the general operating loan facility.

As at September 30, 2016, the Company was in compliance with all covenants relating to its operating loans.

4. Employee Future Benefits

For the three months ended September 30, 2016, defined benefit pension plan actuarial losses of \$1.5 million (before tax) were recognized in other comprehensive income (loss). The losses recorded in the third quarter of 2016 principally reflect a lower discount rate used to value the net defined benefit pension plan obligations offset by the return generated on plan assets. For the nine months ended September 30, 2016, an amount of \$19.0 million (before tax) was charged to other comprehensive income (loss). For the three and nine months ended September 30, 2015, the Company recognized before tax actuarial gains in other comprehensive income (loss) of \$3.8 million and \$6.9 million, respectively.

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 \$26.3 million.

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

	Pension Benefit Plans	Other Benefit Plans
September 30, 2016	3.4%	3.4%
June 30, 2016	3.5%	3.5%
December 31, 2015	4.1%	4.1%
September 30, 2015	4.1%	4.1%
June 30, 2015	3.9%	3.9%
December 31, 2014	3.9%	3.9%

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 September 30, 2016, the fair value of the Company's long-term debt approximates its amortized cost of \$50.0 million (December 31, 2015 - \$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, which are included in Level 2 of the fair value hierarchy, to reduce its exposure to risks associated with fluctuations in foreign exchange rates, energy costs, and floating interest rates on long-term debt. As at September 30, 2016 and December 31, 2015, the Company had no derivative financial instruments outstanding.

The following table summarizes the loss on derivative financial instruments for the three and nine month periods ended September 30, 2016 and 2015:

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Foreign exchange collars	\$ -	\$ (4.2)	\$ -	\$ (9.1)
Crude oil collars	-	(0.7)	-	(0.5)
Interest rate swaps	-	-	-	(0.1)
Loss on derivative financial instruments	\$ -	\$ (4.9)	\$ -	\$ (9.7)

6. Income Taxes

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Current	\$ (7.8)	\$ (11.9)	\$ (17.8)	\$ (28.1)
Deferred	-	1.2	0.2	1.8
Income tax expense	\$ (7.8)	\$ (10.7)	\$ (17.6)	\$ (26.3)

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

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Income tax expense at statutory rate 2016 – 26.0% (2015 – 26.0%)	\$ (7.9)	\$ (10.9)	\$ (17.0)	\$ (26.8)
Add (deduct):				
Entities with different income tax rates and other tax adjustments	0.1	0.2	(0.6)	0.5
Income tax expense	\$ (7.8)	\$ (10.7)	\$ (17.6)	\$ (26.3)

In addition to the amounts recorded to net income, a tax recovery of \$0.4 million was recorded in other comprehensive income (loss) for the three months ended September 30, 2016 (three months ended September 30, 2015 - tax expense of \$1.0 million) in relation to the actuarial gains (losses) on defined benefit employee compensation plans. For the nine month period ended September 30, 2016, a tax recovery of \$5.0 million was recorded in other comprehensive income (loss) (nine months ended September 30, 2015 - tax expense of \$1.8 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 September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Weighted average number of common shares	66,699,368	69,948,740	67,793,394	70,335,187

On March 7, 2016, the Company renewed its normal course issuer bid whereby it can purchase for cancellation up to 3,446,139 common shares or approximately 5% of its issued and outstanding common shares as of March 1, 2016. The renewed normal course issuer bid is set to expire on March 6, 2017. During the third quarter of 2016, CPPI did not purchase any common shares. In early July, \$0.3 million was paid for shares purchased at the end of the second quarter of 2016. As at October 26, 2016, there were 66,699,368 common shares of the Company outstanding and Canfor's ownership interest in CPPI was 53.6%.

8. Net Change in Non-Cash Working Capital

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Accounts receivable	\$ (5.1)	\$ 6.1	\$ 15.4	\$ (9.5)
Inventories	14.2	(8.5)	9.7	(18.8)
Prepaid expenses	(3.0)	(5.2)	(3.7)	0.9
Accounts payable and accrued liabilities	(10.0)	(2.9)	(6.2)	6.3
Net decrease (increase) in non-cash working capital	\$ (3.9)	\$ (10.5)	\$ 15.2	\$ (21.1)

9. Segment Information

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

Sales between the 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, unaudited)	Pulp	Paper	Unallocated	Elimination Adjustment	Consolidated
3 months ended September 30, 2016					
Sales to external customers	\$ 247.9	43.6	0.1	-	\$ 291.6
Sales to other segments	\$ 20.4	-	-	(20.4)	\$ -
Operating income (loss)	\$ 26.7	7.2	(2.9)	-	\$ 31.0
Amortization	\$ 18.1	0.9	-	-	\$ 19.0
Capital expenditures ¹	\$ 12.8	0.8	0.4	-	\$ 14.0
3 months ended September 30, 2015					
Sales to external customers	\$ 253.5	40.5	0.1	-	\$ 294.1
Sales to other segments	\$ 23.9	-	-	(23.9)	\$ -
Operating income (loss)	\$ 38.2	7.1	(3.0)	-	\$ 42.3
Amortization	\$ 15.5	0.9	-	-	\$ 16.4
Capital expenditures ¹	\$ 12.9	1.6	-	-	\$ 14.5
9 months ended September 30, 2016					
Sales to external customers	\$ 708.3	134.3	1.5	-	\$ 844.1
Sales to other segments	\$ 63.1	-	-	(63.1)	\$ -
Operating income (loss)	\$ 61.5	21.6	(7.8)	-	\$ 75.3
Amortization	\$ 51.8	2.8	-	-	\$ 54.6
Capital expenditures ¹	\$ 44.0	1.3	0.4	-	\$ 45.7
Identifiable assets	\$ 727.1	55.3	52.3	-	\$ 834.7
9 months ended September 30, 2015					
Sales to external customers	\$ 719.2	123.1	1.6	-	\$ 843.9
Sales to other segments	\$ 69.8	-	-	(69.8)	\$ -
Operating income (loss)	\$ 92.6	20.7	(8.7)	-	\$ 104.6
Amortization	\$ 45.0	2.6	-	-	\$ 47.6
Capital expenditures ¹	\$ 35.3	5.4	-	-	\$ 40.7
Identifiable assets	\$ 715.1	61.8	31.2	-	\$ 808.1

¹Capital expenditures represent cash paid for capital assets during the periods and include capital expenditures that were partially financed by government grants. Capital expenditures for the nine months ended September 30, 2015 exclude the assets purchased as part of the acquisition of the Taylor pulp mill (Note 12).

10. Related Party Transactions

For the nine months ended September 30, 2016, the Company depended on Canfor to provide approximately 63% (nine months ended September 30, 2015 - 61%) 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, 2015 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, logs, pulp and administrative services. These are summarized below:

(millions of Canadian dollars, unaudited)	3 months ended September 30,		9 months ended September 30,	
	2016	2015	2016	2015
Transactions				
Purchase of wood chips and other	\$ 39.0	\$ 48.7	\$ 120.9	\$ 125.0

(millions of Canadian dollars, unaudited)	As at September 30, 2016	As at December 31, 2015
Balance Sheet		
Included in accounts payable and accrued liabilities	\$ 10.8	\$ 15.6

11. Licella Pulp Joint Venture

On May 27, 2016, CPPI and Licella Fibre Fuel Pty Ltd. ("Licella") agreed to form a joint venture under the name Licella Pulp Joint Venture to investigate opportunities to integrate Licella's Catalytic Hydrothermal Reactor platform into CPPI's pulp mills to economically convert biomass into biofuels and biochemicals.

Licella is a subsidiary of Ignite Energy Resources Ltd. ("IER") an Australian energy technology development company. In conjunction with the joint venture agreement, CPPI provided a \$7.0 million convertible credit facility to IER, which matures on June 21, 2019. The advances on this credit facility are convertible, at CPPI's option, into common shares of IER.

During the second quarter of 2016, CPPI advanced \$3.5 million to IER and exercised its option to convert the amount advanced into common shares of IER. The equity investment is classified as a level 3 available-for-sale financial instrument and is measured at fair value at each reporting period with any gains or losses recognized through other comprehensive income. At September 30, 2016, the fair value of the financial instrument is \$3.8 million resulting in a gain of \$0.2 million (after-tax) recorded in other comprehensive income (loss) in the third quarter of 2016.

The remaining credit facility balance of \$3.5 million is anticipated to be advanced to IER during the fourth quarter of 2016.

12. Purchase of Taylor Pulp Mill

On January 30, 2015, CPPI completed the purchase of the Taylor pulp mill from Canfor for cash consideration of \$12.6 million including working capital. The acquisition also included a long-term fibre supply agreement under which Canfor will supply the Taylor pulp mill with fibre at prices that approximate fair market value. In addition to the cash consideration paid on the acquisition date, CPPI may also pay contingent consideration to Canfor, based on the Taylor pulp mill's annual adjusted operating income before amortization over a three-year period, starting January 31, 2015. On the acquisition date, the fair value of the contingent consideration was \$1.8 million and was recorded as a long-term provision. CPPI recognized long-term assets acquired net of liabilities assumed at a fair value of \$2.8 million and net working capital of \$11.6 million. The acquisition was accounted for in accordance with IFRS 3 *Business Combinations*.

If the acquisition had occurred on January 1, 2015, CPPI's consolidated 2015 sales would have increased by approximately \$8.9 million and consolidated 2015 net income would have increased by approximately \$0.2 million. The Taylor pulp mill's results are recorded in the pulp segment.

Subsequent to the acquisition date, in 2015, CPPI reversed the \$1.8 million contingent consideration provision resulting in a gain recorded to Other Income to reflect lower forecast Bleached Chemi-Thermo Mechanical Pulp prices over the contingent consideration period. The fair value of the contingent consideration provision was nil at September 30, 2016.

13. Subsequent Event

On October 26, 2016, the Board of Directors declared a quarterly dividend of \$0.0625 per share, payable on November 15, 2016, to shareholders of record on November 8, 2016.