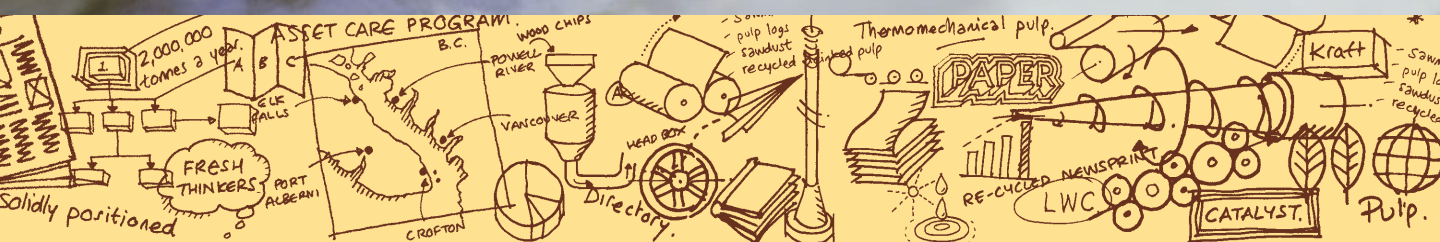


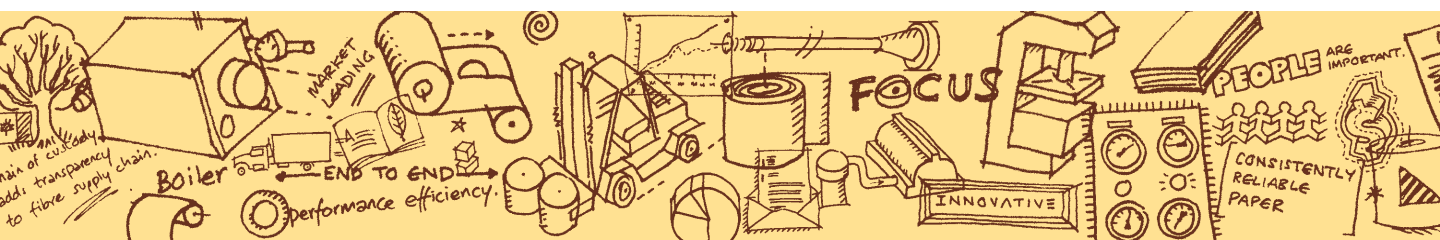
2007  
QUARTERLY  
REPORT

# FRESH THINKING ON PAPER



Q3: Catalyst Paper report for the three months ended September 30, 2007

**Catalyst Paper Corporation** is a leading producer of mechanical printing papers in North America, headquartered in Vancouver, British Columbia. The company also produces market kraft pulp and owns Western Canada's largest paper recycling facility. With five mills employing more than 3,000 people at sites within a 160-kilometre radius on the south coast of BC, Catalyst has a combined annual capacity of 2.4 million tonnes of product. Catalyst's common shares trade on the Toronto Stock Exchange under the symbol CTL.



## President's message

# TO OUR SHAREHOLDERS

We began to see the benefits, in the third quarter, of our business-wide restructuring program as workforce reductions, administrative consolidation and related changes were implemented.

Catalyst continued to implement and expand its restructuring program during the quarter with the announced reduction of a further 85 salaried positions. The previously announced downsizing, corporate office move and consolidation of support functions is on track with all but \$4 million of an expected \$61 million in 2007 restructuring costs now incurred. Total annualized cost savings of approximately \$67 million are expected.

Catalyst Paper posted a net loss of \$18.6 million (\$0.09 per common share) on sales of \$413.7 million in the third quarter of 2007. This compared with net earnings of \$0.2 million (\$nil per common share) on sales of \$441.8 million in the second quarter and to net earnings of \$2.5 million (\$0.01 per common share) on sales of \$486 million for the same period in 2006.

Combined costs of \$37.7 million due to restructuring and the impact of the coastal sawmill strike had a negative impact on earnings before interest, taxes, depreciation and amortization (EBITDA) in the third quarter. Excluding these specific items, EBITDA at \$37.4 million in the quarter improved significantly compared to \$17.4 million in the previous period due to savings from workforce reductions and lower maintenance costs. This helped ease the impact of the strong Canadian dollar which ended the quarter at par with the U.S. dollar.

A total of \$21.6 million in performance improvements were realized during the quarter, bringing year-to-date gains to \$43.6 million.

Growing pricing momentum was evident in this quarter across most products. A tight market for coated mechanical paper grades supported a price increase in the quarter and a further increase was announced for October 1, 2007. Demand was steady for both uncoated specialty and directory grades. Pulp and containerboard markets remained strong and the positive near-term outlook supported price increases for both products in September.

Newsprint continued to disappoint and prices reached their lowest level since 1993 as demand continued to decline. As a result, a machine was indefinitely closed at our Port Alberni mill on September 1, 2007, while newsprint production was also curtailed at our Elk Falls mill due to the coastal fibre strike. The company reduced pulp and paper production by an estimated 64,000 tonnes in the quarter due to the strike and about 12,000 tonnes related to the indefinite closure of the Port Alberni No. 4 paper machine, for a total of 76,000 tonnes.

The third quarter showed the normal reduction in available liquidity as this is the period when annual property tax and insurance premiums are paid. The company's borrowing base was also reduced in the quarter due to lower accounts receivable and inventory as a result of the United Steelworkers coastal fibre strike.

Looking to the balance of the year, pricing momentum is expected to continue and with our restructuring largely complete, the company will enter 2008 at a workforce level that is within reach of best quartile. The coastal fibre strike is resolved, however some impact will be felt at Elk Falls mill as additional production curtailment may be necessary until fibre inventory can be rebuilt to normal levels.

Our ability to reduce costs is well-established and we will continue to focus on this element of our business as a key step to return to profitability.

[Signed]

*Richard Garneau  
President and Chief Executive Officer  
September 30, 2007*

## Management's discussion and analysis

The following management's discussion and analysis ("MD&A") of Catalyst Paper Corporation (the "Company") should be read in conjunction with the unaudited interim consolidated financial statements for the three-month and nine-month periods ended September 30, 2007 and September 30, 2006 and the three-month period ended June 30, 2007.

Throughout the discussion, reference is made to EBITDA, which represents earnings before interest, taxes, depreciation and amortization, and before other non-operating income and expenses, EBITDA before specific items, average delivered cash costs per tonne before specific items, net earnings (loss) before specific items, and net earnings (loss) per share before specific items. Management believes these measures are useful to evaluate the performance of the Company and its business segments. As Canadian Generally Accepted Accounting Principles ("GAAP") do not define a method of calculating these measures, securities regulations require that non-GAAP measures be clearly defined and qualified, and reconciled with their nearest GAAP measure. The definition, calculation, and reconciliation of these non-GAAP measures is provided in Section 8: "Non-GAAP Measures".

In accordance with industry practice, in this MD&A, the term "ton" or the symbol "ST" refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tonnes and the term "tonne" or the symbol "MT" refers to a metric tonne.

In this MD&A, unless otherwise indicated, all dollar amounts are expressed in Canadian dollars, as are the term "dollars" and the symbols "\$" and "CDN\$". The term "U.S. dollars" and the symbol "US\$" refer to United States dollars.

The information in this report is as at November 1, 2007, which is the date of filing in conjunction with the Company's press release announcing its results for the third quarter of 2007. Disclosure contained in this document is current to that date, unless otherwise stated.

### **Cautionary statement regarding forward-looking statements**

This MD&A contains forward-looking statements. Forward-looking statements are statements, other than statements of historical fact, that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. These forward-looking statements can be identified by the use of words such as "anticipate", "could", "expect", "seek", "may", "likely", "intend", "will", "believe" and similar expressions or the negative thereof. These forward-looking statements reflect management's current views and are based on certain assumptions including assumptions as to future economic conditions and courses of action, as well as other factors management believes are appropriate in the circumstances. Such forward-looking statements are subject to risks and uncertainties and no assurance can be given that any of the events anticipated by such statements will occur or, if they do occur, what benefit the Company will derive from them. A number of factors could cause actual results, performance or developments to differ materially from those expressed or implied by such forward-looking statements, including the general economic conditions in the U.S., Canada and internationally, market conditions and demand for the Company's products, the outlook for inventories, production and pricing, the Company's ability to successfully obtain performance improvements and cost savings from its cost reduction initiatives, expected cash flows, capital expenditures and completion of capital projects, shifts in industry capacity, fluctuations in foreign exchange and interest rates, fluctuations in availability and cost of raw materials or energy, the Company's ability to obtain financing and other factors beyond the Company's control. Additional information concerning these and other factors can be found in section 12 of this MD&A under the heading "Risks and Uncertainties". The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Investors are cautioned not to place undue reliance on these forward-looking statements. No forward-looking statement is a guarantee of future results.

## 1 CORPORATE OVERVIEW AND HIGHLIGHTS

### *Third quarter overview*

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The Company recorded an operating loss of \$44.3 million in the third quarter ("Q3"), compared to an operating loss of \$46.7 million in the second quarter ("Q2"). EBITDA was negative \$0.3 million in Q3, compared to negative \$1.9 million in Q2.

The Company's results included restructuring and change-of-control costs of \$24.4 million and \$19.3 million for Q3 and Q2, respectively. In addition, management estimates the current quarter results were negatively impacted by \$13.3 million due to the disruption to the Company's fibre suppliers resulting from the United Steelworkers of Canada union ("USW") work stoppage which began on July 21, 2007. Although the USW strike affected approximately 42% of the Company's fibre supply base, the Company's fibre supply was reduced by approximately 24%, or 134,000 bone dry tonnes in Q3 from the commencement of the strike, as the impact was partially mitigated through higher than expected logging activity and increased supply from other suppliers. Production at the Elk Falls mill was curtailed at the end of August, except for the No. 2 specialty paper machine ("E2") which ran for an additional 23 days, reducing paper and pulp production by 36,300 tonnes and 27,900 tonnes, respectively in Q3. The USW reached an agreement with the Forest Industrial Relations ("FIR") group, the largest bargaining unit for the employers, in mid-October. Of the Company's 42% affected fibre supply base, approximately three-quarters relates to suppliers who are members of FIR.

Q3 EBITDA before specific items of \$37.4 million, improved \$20.0 million compared to EBITDA before specific items of \$17.4 million in Q2. This increase was realized despite the Canadian dollar continuing to strengthen, reaching its highest value versus the U.S. dollar in over 30 years during Q3, ending the quarter at par with the U.S. dollar. Realization of cost savings from the Company's restructuring program and lower maintenance costs were the main factors behind the improvement.

In addition to the planned workforce reductions of approximately 480 positions announced in the first half of 2007, the Company took further action in Q3 to improve its competitive position. In August 2007, the Company announced the elimination of an additional 85 salaried positions, which are expected to result in cost savings of approximately \$13 million annually. Associated restructuring costs, primarily severance related, are expected to be approximately \$16 million. Combined with the initiatives announced in the first half of the year, total annualized cost savings are expected to be approximately \$67 million. Total restructuring costs are expected to be approximately \$61 million, of which \$57 million has been incurred in the first nine months of the year. The remaining \$4 million is expected to be incurred in the fourth quarter.

As announced in May, 2007 the Company indefinitely shut down the Port Alberni No. 4 paper machine ("A4") on September 1, 2007. Curtailment of this machine displaces 134,000 tonnes per year of the Company's least profitable newsprint business and will also reduce the Company's highest cost fibre and power requirements.

In September 2007, the Company sold the Port Alberni No. 3 ("A3") paper machine and ancillary assets. The Company received proceeds of \$1.3 million and recorded a loss on disposal of \$7.4 million on the sale.

Markets improved for a number of the Company's products in Q3. Coated paper markets tightened during Q3 and the US\$60 per ton price increase announced for July 1 was largely implemented. Uncoated mechanical and directory markets remained steady overall. Pulp markets remained strong and price increases were implemented in September for Northern Bleached Softwood Kraft ("NBSK") pulp products and containerboard, including white top linerboard.

Newsprint prices weakened in Q3 in response to declining demand. In Canadian dollar terms, newsprint prices were at their lowest level since 1993. In addition to the indefinite closure of the A4 paper machine, approximately 33,100 tonnes of newsprint paper production was curtailed in Q3 as a result of the fibre disruption caused by the USW strike.

The Company's available liquidity decreased by \$80.8 million in Q3 to \$239.1 million. Of this decrease \$23.1 million was due to a reduction in borrowing base on the Company's revolving operating facility as a result of lower accounts receivable and inventory following curtailment related to the USW strike. In addition, the Company paid its annual property taxes and insurance premiums in Q3 resulting in a cash outflow of \$37.4 million. The Company also spent \$25.0 million related to its capital expenditure program and \$5.2 million related to the ongoing restructuring program.

**Selected financial  
information**

	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
(In millions of dollars, except where otherwise stated)									
Sales	\$1,333.6	<b>\$ 413.7</b>	\$ 441.8	\$ 478.1	\$1,882.5	\$ 470.6	\$ 486.0	\$ 469.6	\$ 456.3
Operating earnings (loss)	(121.7)	<b>(44.3)</b>	(46.7)	(30.7)	3.9	(3.3)	17.0	6.1	(15.9)
EBITDA <sup>1</sup>	11.9	<b>(0.3)</b>	(1.9)	14.1	211.0	48.5	62.8	52.4	47.3
EBITDA before specific items <sup>1</sup>	87.9	<b>37.4</b>	17.4	33.1	211.0	48.5	62.8	52.4	47.3
Net earnings (loss)	(44.0)	<b>(18.6)</b>	0.2	(25.6)	(15.9)	(37.2)	2.5	42.4	(23.6)
Net earnings (loss) before specific items <sup>1</sup>	(68.4)	<b>(16.9)</b>	(31.8)	(19.7)	(25.0)	(7.2)	0.6	(6.7)	(11.7)
EBITDA margin <sup>1, 2</sup>	0.9%	<b>(0.1%)</b>	(0.4%)	2.9%	11.2%	10.3%	12.9%	11.2%	10.4%
EBITDA margin before specific items <sup>1, 2</sup>	6.5%	<b>8.5%</b>	3.9%	6.9%	11.2%	10.3%	12.9%	11.2%	10.4%
Net earnings (loss) per share (in dollars) – basic and diluted	\$ (0.20)	<b>\$ (0.09)</b>	\$ 0.00	\$ (0.12)	\$ (0.07)	\$ (0.17)	\$ 0.01	\$ 0.20	\$ (0.11)
Net earnings (loss) per share before specific items (in dollars) – basic and diluted <sup>1</sup>	(0.32)	<b>(0.08)</b>	(0.15)	(0.09)	(0.12)	(0.03)	0.00	(0.03)	(0.06)
Sales (000 tonnes)									
Specialty paper	775.5	<b>261.1</b>	259.2	255.2	990.2	252.7	264.6	237.8	235.1
Newsprint	425.6	<b>119.8</b>	157.1	148.7	699.1	170.1	169.5	178.4	181.1
Total paper	1,201.1	<b>380.9</b>	416.3	403.9	1,689.3	422.8	434.1	416.2	416.2
Pulp	467.1	<b>151.8</b>	147.4	167.9	626.2	145.5	155.9	171.4	153.4
Total sales	1,668.2	<b>532.7</b>	563.7	571.8	2,315.5	568.3	590.0	587.6	569.6
Production (000 tonnes)									
Specialty paper	789.6	<b>262.6</b>	270.4	256.6	983.7	249.0	254.8	244.2	235.7
Newsprint	411.9	<b>110.9</b>	148.9	152.1	703.7	170.2	170.0	179.6	183.9
Total paper	1,201.5	<b>373.5</b>	419.3	408.7	1,687.4	419.2	424.8	423.8	419.6
Pulp	457.1	<b>143.2</b>	157.1	156.8	624.3	152.8	162.8	155.6	153.1
Total production	1,658.6	<b>516.7</b>	576.4	565.5	2,311.7	572.0	587.6	579.4	572.7

<i>Selected financial information (continued)</i>	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
<small>(In millions of dollars, except where otherwise stated)</small>									
US\$/CDN\$ foreign exchange									
Average spot rate <sup>3</sup>	0.905	<b>0.957</b>	0.911	0.854	0.882	0.878	0.892	0.892	0.866
Period-end spot rate <sup>4</sup>	1.004	<b>1.004</b>	0.940	0.867	0.858	0.858	0.897	0.897	0.857
Effective rate <sup>5</sup>	0.901	<b>0.935</b>	0.916	0.860	0.873	0.878	0.886	0.872	0.853
Common shares (millions)									
At period-end	214.7	<b>214.7</b>	214.7	214.6	214.6	214.6	214.6	214.6	214.6
Weighted average	214.7	<b>214.7</b>	214.7	214.6	214.6	214.6	214.6	214.6	214.6

- EBITDA, EBITDA before specific items, EBITDA margin, EBITDA margin before specific items, net earnings (loss) before specific items, and net earnings (loss) per share before specific items are non-GAAP measures. Refer to Section 8 "Non-GAAP Measures" for further details.
- EBITDA margin and EBITDA margin before specific items are defined as EBITDA and EBITDA before specific items, as a percentage of sales and adjusted sales, respectively. Refer to Section 8 "Non-GAAP Measures" for further details.
- Average spot rate is the average Bank of Canada noon spot rate over the reporting period.
- Period-end spot rate is the Bank of Canada noon spot rate.
- Effective rate represents a blended rate which takes account of the applicable spot rates, the Company's revenue hedging program in the period, and translation of US\$-denominated working capital at period opening and closing rates. See Section 7, "Summary of Quarterly Results" for further details.

## Overview of the business

The Company is the fourth largest North America-based producer of newsprint and mechanical groundwood specialty papers, measured by production capacity. It is also the largest producer of newsprint and uncoated specialty papers and the only producer of lightweight coated ("LWC") paper on the West Coast of North America. The Company is the largest producer of directory paper in the world by capacity and operates the largest paper recycling operation in Western Canada. It also has a significant presence in most major international markets, serving customers around the world.

The Company's business includes printing papers and market pulp, operating in three business segments. A summary of those segments is provided below. For more detailed information, see page 6 of the Company's 2006 Annual Report, which is available on the Company's website at [www.catalystpaper.com](http://www.catalystpaper.com), or the Canadian Securities Administrator's electronic filing website at [www.sedar.com](http://www.sedar.com).

### Specialty paper

The specialty paper segment consists of soft-calendered ("SC") and machine-finished ("MF") hi-brite uncoated, LWC, and directory paper grades. These groundwood specialty paper grades are manufactured on 10<sup>1</sup> paper machines in British Columbia at Crofton, Elk Falls, Port Alberni and Powell River. The specialty paper business segment has a total production capacity of 1,100,000 tonnes.

### Newsprint

Newsprint is currently produced on 5<sup>1</sup> paper machines at Crofton, Elk Falls and Powell River. The newsprint segment has a total annual production capacity of 617,000 tonnes, of which 134,000 tonnes on a 45.0 g/m<sup>2</sup> basis, relating to the Port Alberni No. 4 paper machine, has been indefinitely idled, effective September 1, 2007.

<sup>1</sup> The Company has 11 paper machines. The number of machines noted in the segments above reflects the ability of the Company's machines to switch between newsprint and specialty paper grades.

## Pulp

The pulp segment includes sawdust-based pulp and containerboard manufactured at the Elk Falls mill, and NBSK pulp manufactured at the Crofton mill. The segment has a total market production capacity of 638,000 tonnes.

The Company has a paper recycling operation that is operated in support of its business segments. After a project completed in July 2007, this facility has increased its production capacity from 148,000 to 160,000 air-dried equivalent tonnes of de-inked pulp per year, the majority of which is consumed internally.

The chart below illustrates the Company's principal paper and pulp products, applications and annual 2007 capacity:

### Product profile

Segment	Specialty paper				Newsprint	Pulp	
	Uncoated papers		Coated paper	Directory	Newsprint	Container-board	Market pulp
Category	Soft-calendered	Machine-finished					
Brand name	Electrosoft Electracal Electraprime	Electrabrite Electrastar	Electracote	Catalyst	Marathon	Silverliner Platinumliner Chromiumliner Bronzelineer	Elk Prime Crofton-Kraft
Basis weight (g/m <sup>2</sup> )	36.6 – 52	45 – 66.5	44.4 – 63.6	28 – 40	43 – 48.8	127 – 250	n/a
Applications	magazines, supplements, catalogues, inserts, flyers, directories	magazines, supplements, inserts, flyers, direct mail, PR and corporate communication books/manuals	magazines, catalogues, inserts, flyers, direct mail	telephone books, airline schedules, catalogues	newspapers, inserts, flyers, supplements, directories, timetables	packaging applications	tissue, freesheet, specialty papers, white-top linerboard
Capacity (tonnes)	531,000 <sup>1</sup>		231,000	338,000 <sup>1</sup>	617,000 <sup>1, 2</sup>	127,000	511,000
% of total capacity	23%		10%	14%	26% <sup>2</sup>	5%	22%

<sup>1</sup> Capacities expressed in the above table can vary as the Company is able to switch production between products, particularly newsprint, directory and machine-finished uncoated grades.

<sup>2</sup> The Company indefinitely curtailed the A4 paper machine in Port Alberni effective September 1, 2007, displacing 134,000 tonnes of the Company's annual newsprint production. The capacity noted in the table above is not adjusted for this indefinite curtailment. If adjusted, newsprint capacity would decline to 483,000 tonnes, or 21% of total capacity.

## 2007 strategy update

The Company's long-term objective is to achieve higher, sustainable earnings and maximize cash flow by strengthening its position as a leading producer of value-added paper.

The Company is focused on reducing manufacturing costs while maintaining or improving the quality of its products. The Company is also focused on optimizing production of its brands and customer base to take advantage of market conditions. During Q3, the Company realized \$21.6 million in performance improvements and cost savings, including savings related to the 2007-restructuring program, bringing year-to-date EBITDA improvements from all initiatives to \$43.6 million as summarized below.

<b>2007 Performance Improvement Program Initiatives</b>	<b>07</b>
	<i>Realized YTD</i>
<small>(All amounts are pre-tax and in millions of dollars)</small>	
Workforce reduction	<b>\$ 17</b>
Product and grade optimization	<b>12</b>
Energy	<b>4</b>
Fibre optimization	<b>3</b>
Chemical costs	<b>2</b>
Productivity improvements	<b>2</b>
Kraft usage	<b>2</b>
Other	<b>2</b>
<b>Total performance improvement program</b>	<b>\$ 44</b>

At January 1, 2007, the Company had 3,680 positions. This number has been reduced to 3,261 positions at September 30, 2007. The reduction of 419 year-to-date comprises 356 positions eliminated through the 2007 restructuring program, representing 63% of the target of 565, and 63 employees laid off to date associated with the indefinite closure of the A4 paper machine.

## Consolidated results of operations

### Three months ended September 30, 2007 compared to three months ended June 30, 2007

#### Sales

Sales in Q3, 2007 decreased \$28.1 million compared to Q2, 2007. The decrease in sales was largely due to decreases in newsprint and pulp sales volumes, caused by the curtailment of operations at Elk Falls during Q3 due to the USW strike, and the indefinite closure of the A4 Port Alberni paper machine on September 1, 2007. Sales also decreased due to a stronger Canadian dollar and lower transaction prices for newsprint grades. The decrease in sales was partially offset by the positive impact of higher average transaction prices for coated paper and pulp products.

**EBITDA and EBITDA  
before specific items**

	EBITDA <sup>1</sup>	EBITDA before specific items <sup>1</sup>
(\$ millions)		
<b>Q2, 2007</b>	<b>\$ (1.9)</b>	<b>\$ 17.4</b>
Paper prices	(2.7)	(2.7)
Pulp prices	3.5	3.5
Impact of Canadian dollar, net of hedging	(5.8)	(5.8)
Maintenance cost	10.2	10.2
Workforce savings	4.0	4.0
USW strike impact	(13.3)	–
Restructuring cost	(5.1)	–
Other, net	10.8	10.8
<b>Q3, 2007</b>	<b>\$ (0.3)</b>	<b>\$ 37.4</b>

<sup>1</sup> EBITDA and EBITDA before specific items are non-GAAP measures. Refer to Section 8 “Non-GAAP Measures” for further details.

EBITDA before specific items increased \$20.0 million in Q3, 2007 compared to Q2, 2007. Lower planned maintenance spending, higher transaction prices for pulp products and the realization of benefits from performance improvements, particularly from workforce reduction, more than offset the negative impact of the stronger Canadian dollar, and weaker newsprint prices. Including the impact of restructuring and USW strike related costs, EBITDA increased \$1.6 million in Q3, 2007 compared to Q2, 2007.

**Operating earnings (loss)**

The Company reported an operating loss of \$44.3 million for Q3, which was comparable to the operating loss of \$46.7 million for Q2, 2007.

**Net earnings (loss)**

Net loss in Q3, 2007 of \$18.6 million (\$0.09 per common share) was a decrease of \$18.8 million compared to net earnings of \$0.2 million (less than \$0.01 per common share) in Q2, 2007. After adjusting for specific items, adjusted net loss in Q3, 2007 was \$16.9 million (\$0.08 per common share), an improvement of \$14.9 million from net loss before specific items of \$31.8 million (\$0.15 per common share) in the previous quarter. Refer to Section 8, “Non-GAAP Measures” for details on net earnings (loss) before specific items.

**Three months and nine months ended September 30, 2007 compared to three months  
and nine months ended September 30, 2006****Sales**

Sales decreased by \$72.3 million and \$78.3 million in Q3 and the first nine months of 2007, respectively, compared to the same periods in 2006. The negative impact of lower sales volumes, primarily related to the USW strike, the stronger Canadian dollar, and weaker prices for newsprint and coated and uncoated mechanical grades, more than offset improved average transaction prices for the Company’s directory and pulp products.

<i>EBITDA and EBITDA before specific items</i>	<i>EBITDA</i> <sup>1</sup>		<i>EBITDA before specific items</i> <sup>1</sup>	
	Q3	YTD	Q3	YTD
(\$ millions)				
<b>2006</b>	<b>\$ 62.8</b>	<b>\$ 162.5</b>	<b>\$ 62.8</b>	<b>\$ 162.5</b>
Paper prices	(20.0)	(38.5)	(20.0)	(38.5)
Pulp prices	10.9	48.5	10.9	48.5
Impact of Canadian dollar, net of hedging	(15.5)	(32.0)	(15.5)	(32.0)
Workforce savings	9.4	17.2	9.4	17.2
Fibre cost	(15.9)	(57.8)	(15.9)	(57.8)
Restructuring and change-of-control costs	(24.4)	(62.7)	–	–
USW strike impact	(13.3)	(13.3)	–	–
Other, net	5.7	(12.0)	5.7	(12.0)
<b>2007</b>	<b>\$ (0.3)</b>	<b>\$ 11.9</b>	<b>\$ 37.4</b>	<b>\$ 87.9</b>

<sup>1</sup> EBITDA and EBITDA before specific items are non-GAAP measures. Refer to Section 8 "Non-GAAP Measures" for further details.

EBITDA before specific items decreased by \$25.4 million and \$74.6 million, respectively, from the comparative periods in 2006. The negative impact of the stronger Canadian dollar, weaker average paper prices, higher fibre costs and inflation more than offset improved average transaction prices for the Company's pulp products, the realization of benefits from performance improvements, particularly from workforce reduction, and other positive factors in the periods. Including the impact of the USW strike and restructuring and change-of-control costs, EBITDA decreased by \$63.1 million and \$150.6 million in Q3 and the first nine months of 2007, respectively, compared to the same periods in 2006.

### *Operating earnings (loss)*

Operating loss increased by \$61.3 million and \$128.9 million in Q3 and the first nine months of 2007, respectively, compared to the same periods in 2006. The increase in operating loss from the comparative periods was primarily related to the \$63.1 million and \$150.6 million decreases in EBITDA noted above, partially offset by a \$17.6 million additional depreciation charge in the first nine months of 2006 due to an impairment charge in Q1 2006 related to the permanently closed A3 paper machine at Port Alberni.

### *Net earnings (loss)*

Net loss was \$18.6 million (\$0.09 per common share) and \$44.0 million (\$0.20 per common share), respectively, in Q3 and the first nine months of 2007. Net loss increased by \$21.1 million and \$65.3 million, respectively, from the comparative periods in 2006. Net loss before specific items in Q3 and the first nine months of 2007 was \$16.9 million (\$0.08 per common share) and \$68.4 million (\$0.32 per common share), respectively. Net loss before specific items was a decrease of \$17.5 million from net earnings before specific items of \$0.6 million (less than \$0.01 per common share) in Q3 2006 and increased \$50.6 million from net loss before specific items of \$17.8 million (\$0.09 per common share) in the first 9 months of 2006. Refer to Section 8, "Non-GAAP Measures" for details on net earnings (loss) before specific items.

## 2 SEGMENTED RESULTS OF OPERATIONS

### Specialty paper

Summary of selected financial information	YTD	07			TOTAL	06			
		Q3	Q2	Q1		Q4	Q3	Q2	Q1
(In millions of dollars, except where otherwise stated)									
Sales	\$ 685.3	\$ 222.1	\$ 225.1	\$ 238.1	\$ 918.4	\$ 234.0	\$ 245.0	\$ 218.6	\$ 220.8
EBITDA <sup>1</sup>	13.7	0.0	4.1	9.6	104.8	18.4	31.6	25.7	29.1
EBITDA before specific items <sup>1</sup>	57.3	17.6	17.0	22.7	104.8	18.4	31.6	25.7	29.1
Operating earnings (loss)	(61.6)	(26.3)	(21.1)	(14.2)	9.7	(6.6)	6.9	2.8	6.6
EBITDA margin <sup>1, 2</sup>	2.0%	0.0%	1.8%	4.0%	11.4%	7.9%	12.9%	11.8%	13.2%
EBITDA margin before specific items <sup>1, 2</sup>	8.3%	8.0%	7.6%	9.5%	11.4%	7.9%	12.9%	11.8%	13.2%
Sales (000 tonnes)	775.5	261.1	259.2	255.2	990.2	252.7	264.6	237.8	235.1
Production (000 tonnes)	789.6	262.6	270.4	256.6	983.7	249.0	254.8	244.2	235.7
Curtailement (000 tonnes) <sup>3</sup>	3.2	3.2	–	–	–	–	–	–	–
Average sales revenue per tonne	\$ 884	\$ 850	\$ 868	\$ 933	\$ 928	\$ 927	\$ 926	\$ 920	\$ 939
Average delivered cash costs per tonne <sup>4</sup>	866	849	852	896	822	853	806	811	815
Average delivered cash costs per tonne before specific items <sup>1</sup>	809	781	802	845	822	853	806	811	815
SC-A paper, 35 lb. (US\$/ton) <sup>5</sup>	747	745	745	752	788	787	800	785	780
LWC paper, No. 5, 40 lb. (US\$/ton) <sup>5</sup>	766	782	748	767	836	798	820	852	873
Telephone directory paper, 22.1 lb. (US\$/ton) <sup>5</sup>	765	765	765	765	721	725	725	720	715

1 EBITDA, EBITDA before specific items, EBITDA margin, EBITDA margin before specific items, and average delivered cash costs per tonne before specific items are non-GAAP measures. Refer to Section 8 "Non-GAAP Measures" for further details.

2 EBITDA margin and EBITDA margin before specific items are defined as EBITDA and EBITDA before specific items as a percentage of sales and adjusted sales, respectively. Refer to Section 8 "Non-GAAP Measures" for further details.

3 Curtailement consists of downtime related to the USW strike.

4 Average delivered cash costs per tonne consist of cost of sales, including the impact of the USW strike, selling, general and administration ("SG&A") costs, and restructuring and change-of-control costs.

5 Benchmark selling prices are sourced from Resource Information Systems, Inc. ("RISI").

## Segment overview

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Market conditions improved for specialty paper products in Q3. Coated mechanical demand increased 9.9% in Q3 year-over-year and 4.8% year-to-date. Although magazine and catalogue demand was flat, the increase in North American coated paper demand and shipments was primarily due to grade switching from coated free sheet to coated mechanical and lower imports from Europe. Supply in the coated mechanical market tightened during Q3, largely due to significant North American mill closures in the quarter and lower mill inventories. The US\$60 per ton price increase announced for July 1 was largely implemented during the quarter and a further US\$60 per ton price increase was announced, effective October 1, 2007. The Q3, 2007 average LWC benchmark price was US\$782, an increase of US\$34 per ton, or 4.5% from Q2, 2007. Compared to Q3, 2006, the average benchmark price was down US\$38 per ton, or 4.6%.

Uncoated mechanical (high-gloss, standard, and lightweight) demand was up slightly in Q3 as increased demand for high-gloss grades outpaced declining demand for standard grades. Demand for high-gloss grades increased 9.6% year-over-year in Q3 compared to the same quarter last year, while standard uncoated mechanical grade demand was down 6.2% in Q3 year-over-year. The Company did not implement the US\$60 per ton price increase in Q3, for SC and soft-nip calendered ("SNC") grades, announced in Q2. The average benchmark price for super-calendered grade A ("SC-A") in Q3, 2007 was US\$745 per ton, consistent with Q2, 2007 and a US\$55 per ton, or 6.9% decrease from the same quarter last year.

North American directory demand was up 4.7% in Q3 year-over-year, and 1.2% year-to-date due to growth in the number of directories published. The average benchmark price for Q3, 2007 was US\$765 per ton, which was in line with Q2, 2007. Compared to Q3, 2006, the average benchmark price was up US\$40 per ton, or 5.5%.

As a result of the USW strike in Q3 and related fibre supply disruptions, the Company temporarily curtailed its E2 uncoated paper machine for approximately 8 days in the quarter. As a result of this curtailment, management estimates uncoated paper production was reduced by 3,200 tonnes during the quarter.

## Operational performance

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### *Three months ended September 30, 2007 compared to three months ended June 30, 2007*

The specialty paper business operating loss increased \$5.2 million from Q2, 2007.

Sales volume increased 1,900 tonnes from Q2, 2007 as an increase in directory shipments was largely offset by a decrease in coated and uncoated paper shipments. Average sales revenue decreased \$18 per tonne from the previous quarter, due to the stronger Canadian dollar.

Average delivered cash costs improved \$3 per tonne compared to Q2, 2007, as the impact of restructuring costs and costs associated with the USW strike were more than offset by performance improvements. Before the impact of specific items, average cash costs were \$781 per tonne, a decrease of \$21 per tonne from the previous quarter.

### *Three months and nine months ended September 30, 2007 compared to three months and nine months ended September 30, 2006*

The specialty paper business operating loss increased \$33.2 million and \$77.9 million in Q3 and the first nine months of 2007, respectively, compared to the same periods in 2006.

Sales volume decreased 3,500 tonnes and increased 38,000 tonnes, respectively, from the comparative periods in 2006. The decrease from Q3, 2006 was largely due to lower coated paper shipments, whereas the increase in the first nine months of 2007 primarily related to switching machine production to directory from newsprint. Average sales revenue decreased by \$76 per tonne and \$44 per tonne, respectively, as the stronger Canadian dollar and weaker coated and uncoated paper prices more than offset higher prices for directory grades.

Average delivered cash costs increased \$43 per tonne and \$55 per tonne, respectively, from the comparative periods in 2006. This was primarily due to the impact of restructuring costs, higher fibre costs, and the negative impact of the USW strike, which more than offset savings from performance improvements. Before the impact of specific items, average delivered cash costs were \$781 per tonne and \$806 per tonne, respectively, a decrease of \$25 per tonne and \$5 per tonne from the comparative periods in 2006.

## Newsprint

### Summary of selected financial information

	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
(In millions of dollars, except where otherwise stated)									
Sales	\$ 293.8	\$ 77.8	\$ 106.7	\$ 109.3	\$ 529.8	\$ 128.4	\$ 128.8	\$ 135.4	\$ 137.2
EBITDA <sup>1</sup>	(15.4)	(8.1)	(4.2)	(3.1)	71.8	14.5	18.2	19.3	19.8
EBITDA before specific items <sup>1</sup>	–	(0.4)	(0.2)	0.6	71.8	14.5	18.2	19.3	19.8
Operating earnings (loss)	(42.4)	(15.6)	(13.5)	(13.3)	6.9	1.9	7.5	7.4	(9.9)
EBITDA margin <sup>1, 2</sup>	(5.2%)	(10.4%)	(3.9%)	(2.8%)	13.6%	11.3%	14.1%	14.3%	14.4%
EBITDA margin before specific items <sup>1, 2</sup>	0.0%	(0.8%)	0.0%	0.0%	13.6%	11.3%	14.1%	14.3%	14.4%
Sales (000 tonnes)	425.6	119.8	157.1	148.7	699.1	170.1	169.5	178.4	181.1
Production (000 tonnes)	411.9	110.9	148.9	152.1	703.7	170.2	170.0	179.6	183.9
Curtailement (000 tonnes) <sup>3</sup>	33.1	33.1	–	–	–	–	–	–	–
Average sales revenue per tonne	\$ 690	\$ 650	\$ 679	\$ 735	\$ 758	\$ 754	\$ 761	\$ 759	\$ 758
Average delivered cash costs per tonne <sup>4</sup>	726	720	706	756	655	669	653	651	647
Average delivered cash costs per tonne before specific items <sup>1</sup>	686	646	681	731	655	669	653	651	647
Newsprint 48.8 gsm, West Coast delivery (US\$/tonne) <sup>5</sup>	584	561	584	606	649	649	658	651	640

1 EBITDA, EBITDA before specific items, EBITDA margin, EBITDA margin before specific items and average delivered cash costs per tonne before specific items are non-GAAP measures. Refer to Section 8 "Non-GAAP Measures" for further details.

2 EBITDA margin and EBITDA margin before specific items are defined as EBITDA and EBITDA before specific items as a percentage of sales and adjusted sales, respectively. Refer to Section 8 "Non-GAAP Measures" for further details.

3 Curtailement consists of downtime related to the USW strike but does not include the indefinite closure of the A4 paper machine at Port Alberni.

4 Average delivered cash costs per tonne consist of cost of sales, including the impact of the USW strike, SG&A costs, and restructuring and change-of-control costs.

5 Benchmark selling prices are sourced from RISI.

## **Segment overview**

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U.S. newsprint consumption decreased 9.6% in Q3, year-over-year, and 10.6% year-to-date and as a result prices continued to decline in North America. The average newsprint benchmark price in Q3, 2007 was US\$561 per tonne, down US\$23 per tonne, or 3.9%, from Q2, 2007. Compared to Q3, 2006, the average benchmark price has decreased US\$97 per tonne, or 14.7%.

As a result of the USW strike and related fibre supply disruptions, the Company temporarily curtailed its Elk Falls No.1 and No.5 newsprint machines, effective in late August for 32 days in Q3. As a result of this curtailment, management estimates newsprint production was reduced by 33,100 tonnes during the quarter.

As announced in May 2007, the Company indefinitely curtailed the A4 paper machine in Port Alberni on September 1, 2007, displacing 134,000 tonnes per year of the Company's least profitable newsprint business. Management estimates this reduced the Company's newsprint production by approximately 12,400 tonnes in Q3, 2007.

## **Operational performance**

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### **Three months ended September 30, 2007 compared to three months ended June 30, 2007**

The newsprint business operating loss increased \$2.1 million to \$15.6 million from the previous quarter.

Sales volume decreased 37,300 tonnes compared to Q2, 2007, primarily due to the USW strike and the indefinite closure of the A4 paper machine. Average sales revenue decreased \$29 per tonne from Q2, 2007, due to lower transaction prices and the stronger Canadian dollar.

Average delivered cash costs increased \$14 per tonne from Q2, 2007. The impact of the USW strike and higher restructuring costs were partially offset by savings from performance improvements. Before specific items, average delivered cash costs were \$646 per tonne, a decrease of \$35 per tonne from the previous quarter.

### **Three months and nine months ended September 30, 2007 compared to three months and nine months ended September 30, 2006**

The newsprint business operating loss increased \$23.1 million and \$47.4 million for Q3 and the first nine months of 2007, respectively, compared to the same periods in 2006.

Sales volume decreased 49,700 tonnes and 103,400 tonnes, respectively, from the comparable periods, primarily due to the flexibility to swing machine production to increase directory production in 2007, and the USW strike and the indefinite closure of the A4 paper machine in Q3 2007. Average sales revenue decreased \$111 per tonne and \$69 per tonne, respectively, due to lower transaction prices and the negative impact of the stronger Canadian dollar.

Average delivered cash costs increased \$67 per tonne and \$75 per tonne, respectively, from the comparative periods in 2006. The impact of restructuring costs, costs associated with the USW strike, higher fibre costs, and higher year-to-date planned maintenance costs were the primary drivers of the increase and offset cost savings from performance improvements. Before the impact of specific items, average delivered cash costs were \$646 per tonne and \$686 per tonne, respectively, a decrease of \$7 per tonne and an increase of \$35 per tonne, respectively, from the comparative periods in 2006.

## Pulp

## Summary of selected financial information

	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
(In millions of dollars, except where otherwise stated)									
Sales	\$ 354.5	\$ 113.8	\$ 110.0	\$ 130.7	\$ 434.3	\$ 108.2	\$ 112.2	\$ 115.6	\$ 98.3
EBITDA <sup>1</sup>	13.6	7.8	(1.8)	7.6	34.4	15.6	13.0	7.4	(1.6)
EBITDA before specific items <sup>1</sup>	30.6	20.2	0.6	9.8	34.4	15.6	13.0	7.4	(1.6)
Operating earnings (loss)	(17.7)	(2.4)	(12.1)	(3.2)	(12.7)	1.4	2.6	(4.1)	(12.6)
EBITDA margin <sup>1, 2</sup>	3.8%	6.9%	(1.6%)	5.8%	7.9%	14.4%	11.6%	6.4%	(1.6%)
EBITDA margin before specific items <sup>1, 2</sup>	8.4%	16.2%	0.5%	7.5%	7.9%	14.4%	11.6%	6.4%	(1.6%)
Sales (000 tonnes)	467.1	151.8	147.4	167.9	626.2	145.5	155.9	171.4	153.4
Production (000 tonnes)	457.1	143.2	157.1	156.8	624.3	152.8	162.8	155.6	153.1
Curtailed (000 tonnes) <sup>3</sup>	27.9	27.9	–	–	–	–	–	–	–
Average sales revenue per tonne	\$ 759	\$ 750	\$ 746	\$ 778	\$ 693	\$ 744	\$ 720	\$ 674	\$ 641
Average delivered cash costs per tonne <sup>1, 4</sup>	730	699	759	732	638	636	637	630	652
Average delivered cash costs per tonne before specific items <sup>1</sup>	692	622	743	719	638	636	637	630	652
NBSK pulp, Northern Europe delivery (US\$/tonne) <sup>5</sup>	783	810	783	757	681	737	710	665	618
White-top linerboard, 42 lb., Eastern U.S. delivery (US\$/ton) <sup>5</sup>	689	707	680	680	673	680	680	680	650

1 EBITDA, EBITDA before specific items, EBITDA margin, EBITDA margin before specific items and average delivered cash costs per tonne before specific items are non-GAAP measures. Refer to Section 8 "Non-GAAP Measures" for further details.

2 EBITDA margin and EBITDA margin before specific items are defined as EBITDA and EBITDA before specific items as a percentage of sales and adjusted sales, respectively. Refer to Section 8 "Non-GAAP Measures" for further details.

3 Curtailed consists of downtime related to the USW strike.

4 Average delivered cash costs per tonne consist of cost of sales, including the impact of the USW strike, SG&A costs, and restructuring and change-of-control costs.

5 Benchmark selling prices are sourced from RISI.

## Segment overview

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Global NBSK pulp markets continued to be strong with global pulp shipments up 5.2% in Q3 year-over-year and 2.7% year-to-date. Strong demand and low inventories prompted NBSK price increases of US\$10 per tonne to US\$30 per tonne, effective September 2007. The average Northern Europe NBSK benchmark price in Q3, 2007 was US\$810 per tonne, up US\$27 per tonne, or 3.4%, from Q2, 2007. Compared to Q3, 2006, the average benchmark price increased US\$100 per tonne, or 14.1%.

In Q3, linerboard demand increased by 0.7% year-over-year. The average white-top linerboard benchmark price in Q3, 2007 was up US\$27 per ton or 4.0% higher than Q2, 2007 as the previously announced US\$45 per ton increase was implemented September 1, 2007.

As a result of the USW strike in Q3 and related fibre supply disruptions, the Company temporarily curtailed its Elk Falls pulp mill and containerboard machine in late August for 32 days in Q3. As a result of this curtailment management estimates pulp and containerboard production were reduced by 27,900 tonnes during the quarter.

## Operational performance

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### *Three months ended September 30, 2007 compared to three months ended June 30, 2007*

The pulp and containerboard business operating loss decreased \$9.7 million from Q2, 2007.

Sales volume increased 4,400 tonnes from Q2, 2007, primarily due to continued strong pulp market conditions and the absence of maintenance shutdowns in Q3 more than offsetting the impact of the USW strike. Average sales revenue increased \$4 per tonne from Q2, 2007, with higher pulp prices more than offsetting the stronger Canadian dollar.

Average delivered cash costs improved \$60 per tonne from Q2, 2007, as lower planned maintenance costs and performance improvements more than offset costs associated with the USW strike and the impact of restructuring costs. Before specific items, average delivered cash costs were \$622 per tonne, a decrease of \$121 per tonne from the previous quarter.

### *Three months and nine months ended September 30, 2007 compared to three months and nine months ended September 30, 2006*

The pulp and containerboard business operating loss increased \$5.0 million and \$3.6 million for Q3 and the first nine months of 2007, respectively, compared to the same periods in 2006.

Sales volume decreased 4,100 tonnes and 13,600 tonnes, respectively, from the comparative periods, primarily due to the curtailment of the Elk Falls mill in Q3 due to the USW strike. Average sales revenue increased \$30 per tonne and \$81 per tonne, respectively, with higher transaction prices outpacing the strengthening Canadian dollar.

Average delivered cash costs increased \$62 per tonne and \$91 per tonne, respectively, from the comparative periods as the impact of restructuring costs, significantly increased fibre costs, and costs associated with the USW strike more than offset lower planned maintenance spending in Q3 2007 and performance improvements. Before the impact of specific items, average delivered cash costs were \$622 per tonne and \$692 per tonne, respectively, a decrease of \$15 per tonne and an increase of \$53 per tonne, respectively, from the comparative periods in 2006.

### 3 LIQUIDITY AND CAPITAL RESOURCES

#### Selected financial information

	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
(In millions of dollars, except where otherwise stated)									
Cash flows (used) provided by operations before changes in non-cash operating working capital	\$ (55.9)	\$ (17.8)	\$ (29.4)	\$ (8.7)	\$ 136.4	\$ 41.5	\$ 40.2	\$ 20.1	\$ 34.6
Changes in non-cash working capital	18.7	(16.3)	25.4	9.6	(8.6)	2.5	(27.4)	18.2	(1.9)
Cash flows (used) provided by operations	(37.2)	(34.1)	(4.0)	0.9	127.8	44.0	12.8	38.3	32.7
Cash flows used by investing activities	(65.9)	(23.7)	(22.2)	(20.0)	(85.8)	(39.6)	(18.8)	(16.8)	(10.6)
Cash flows provided (used) by financing activities	67.6	57.8	9.7	0.1	(6.5)	–	–	–	(6.5)
Capital spending	68.3	25.0	23.0	20.3	93.2	41.0	22.9	17.5	11.8
Amortization <sup>1</sup>	133.6	44.0	44.8	44.8	207.1	51.8	45.8	46.3	63.2
Capital spending as % of amortization	51%	57%	51%	45%	45%	79%	50%	38%	19%
Total debt to total capitalization <sup>2, 3</sup>	45%	45%	44%	46%	46%	46%	44%	44%	46%
Net debt to net capitalization <sup>4, 5</sup>	45%	45%	44%	46%	45%	45%	43%	43%	46%

1 Quarter 1, 2006 amortization expense includes a \$17.6 million impairment loss related to the permanent closure of the A3 paper machine. Quarter 4, 2006 amortization expense includes a \$1.5 million impairment loss related to the permanent closure of the A3 paper machine and \$4.3 million in other asset impairments.

2 Total debt comprises long-term debt, including current portion.

3 Total capitalization comprises total debt and shareholders' equity.

4 Net debt comprises total debt, less cash on hand.

5 Net capitalization comprises net debt and shareholders' equity.

The Company's principal cash requirements are for interest payments on its debt, capital expenditures and working capital. Cash flows are funded through operations and, where necessary, through the revolving operating facility (the "Facility"). If necessary, liquidity requirements may be funded through the issuance of debt, equity or both. Access to current and alternative sources of financing at competitive cost is dependent upon the Company's credit ratings and capital market conditions. The Company believes that the cash flow from operations and the Facility will be sufficient to meet its anticipated capital expenditures and debt service obligations in the near and intermediate term.

### ***Operating activities***

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Cash used by operating activities in the current quarter was \$34.1 million, compared to cash used of \$4.0 million in the previous quarter, and cash provided of \$12.8 million in the same quarter last year. The decrease of \$30.1 million from the previous quarter is primarily related to \$37.4 million of annual property tax and insurance premium payments. The decrease of \$46.9 million from the same quarter last year was primarily due to the \$63.1 million decrease in EBITDA, partially offset by reductions in inventory and accounts receivable due to the USW strike.

### ***Investing activities***

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Cash used for investing activities in the current quarter totalled \$23.7 million, which was comparable with cash used of \$22.2 million in the previous quarter, and an increase of \$4.9 million from the same quarter last year. Investing activities are largely comprised of capital spending. Consequently, movements in cash flows are primarily due to changes in capital spending.

The current quarter's capital spending was \$25.0 million and was comprised of capital maintenance expenditures and various small high-return capital projects, including a number of projects for the purposes of increasing product quality.

### ***Financing activities***

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Cash provided by financing activities was \$57.8 million in the current quarter, compared to cash provided of \$9.7 million in the previous quarter and cash provided of \$nil in the same quarter last year. The increase from the comparative periods was primarily due to an increase of \$57.7 million borrowing on the Facility related to the decrease in operating cash flow described in section 3.1.

## Debt

Total long-term debt outstanding as at September 30, 2007 was \$799.8 million. The Company's net debt to net capitalization ratio as at September 30, 2007, was 45%, or 1%, higher than the previous quarter and consistent with December 31, 2006.

The following table illustrates the changes in the Company's long-term debt for the nine months ended September 30, 2007:

<i>Issue</i>	<i>January 1, 2007<sup>1</sup></i>	<i>Net increase (decrease)</i>	<i>Foreign exchange</i>	<i>September 30, 2007</i>
<i>(In millions of dollars)</i>				
<b>Recourse</b>				
Senior notes, 8.625% due June 2011 (US\$400.0 million)	\$ 459.3	\$ –	\$ (67.6)	\$ 391.7
Senior notes, 7.375% due March 2014 (US\$250.0 million)	288.8	–	(42.3)	246.5
Revolving operating facility of up to \$350.0 million due July 2009 with interest based on Canadian Prime/BA rates or U.S. Base/LIBOR rates	–	67.1	–	67.1
<b>Non-recourse (PREI)</b>				
First mortgage bonds, 6.387% due July 2009	74.5	–	–	74.5
Subordinated promissory notes	19.5	–	–	19.5
Loan payable	–	0.5	–	0.5
<b>Total long-term debt</b>	<b>\$ 842.1</b>	<b>\$ 67.6</b>	<b>\$ (109.9)</b>	<b>\$ 799.8</b>

<sup>1</sup> Effective January 1, 2007, the Company adopted the CICA Sections "Comprehensive Income", 3251 "Equity", 3855 "Financial Instruments – Recognition and Measurement", 3861 "Financial Instruments – Disclosure and Presentation", and 3865 "Hedges".

Availability on the Company's \$350 million Facility at period-end is summarized in the following table:

	<b>Q3</b>	<b>07 Q2</b>	<b>Q1</b>	<b>Q4</b>	<b>Q3</b>	<b>06 Q2</b>	<b>Q1</b>
<i>(In millions of dollars)</i>							
Borrowing base	<b>\$ 326.9</b>	\$ 350.0	\$ 350.0	\$ 350.0	\$ 350.0	\$ 335.1	\$ 345.5
Letters of credit	<b>20.7</b>	20.7	22.8	26.4	22.7	22.7	22.3
Amount drawn, net	<b>67.1</b>	9.4	–	–	–	–	–
Available to be drawn	<b>\$ 239.1</b>	\$ 319.9	\$ 327.2	\$ 323.6	\$ 327.3	\$ 312.4	\$ 323.2

As of September 30, 2007, the Company had \$239.1 million available on its \$350 million facility. The amount drawn on the Facility increased by \$57.7 million in the quarter and the Company's available liquidity decreased by \$80.8 million. Of this decrease, \$23.1 million was due to a reduction in borrowing base on the Company's Facility as a result of lower accounts receivable and inventory following curtailment related to the USW strike. In addition, the Company paid its annual property taxes and insurance premiums in Q3 resulting in a cash outflow of \$37.4 million. The Company also spent \$25.0 million related to its capital expenditure program and \$5.2 million related to the ongoing restructuring program. Availability under the Facility is determined by a borrowing base, which is calculated based on accounts receivable and inventory balances. The Company is in compliance with the covenants under its Facility, which includes covenants to maintain the funded debt/capitalization ratio below 60%, secured debt/capitalization ratio below 30%, and shareholders' equity above \$779.3 million as at September 30, 2007.

The Company is in compliance with the covenants under its senior notes indentures. The Company's Fixed Charge Coverage Ratio ("FCC Ratio") under the senior notes indentures calculated on a 12-month trailing average was 1.4:1 as at September 30, 2007 (2.0:1 as at June 30, 2007). While the FCC Ratio is below 2.0:1, the Company is limited in the amount of additional debt it may incur to "permitted debt" under the senior notes. Under the indenture of the 8.625% senior notes, "permitted debt" includes a) the existing 8.625% and 7.375% senior notes, b) a credit facility basket in an amount equal to the greater of i) \$725 million, and ii) the sum of 75% of the book value of the Company's accounts receivable, 50% of the book value of the Company's inventory, and \$290 million, against which in either case utilization under the Company's \$350 million Facility is applied, c) purchase money debt and capital lease obligations in an amount equal to 5% of consolidated tangible assets, d) a \$40 million general basket, and e) a \$5 million basket for accommodation guarantees, trade or standby letters of credit, performance bonds, bankers' acceptances and surety notes. The indenture for the 7.375% notes contains larger debt baskets, but while the 8.625% notes remain outstanding the Company is bound by their more restrictive provisions.

Also under the senior note covenants, the Company is restricted from making certain payments, including the payment of dividends, unless the balances in its restricted payments baskets are positive. The Company's restricted payments baskets under the 8.625% and 7.375% senior notes were negative \$194.1 million and negative \$169.1 million, respectively, as at September 30, 2007 (negative \$152.4 million and negative \$127.4 million, respectively, as at June 30, 2007), as a result of the accumulation of losses in recent years.

After the quarter end, in October 2007, Standard & Poor's Rating Services lowered its long-term corporate credit and senior unsecured ratings to B from B+ and its senior secured rating to B+ from BB-. The outlook remains unchanged at negative. The strong Canadian currency and weak newsprint prices were the primary factors cited in the downgrade.

### **Financial instruments**

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In the normal course of business, the Company is exposed to foreign currency and price risk associated with revenues and long-term debt, which are predominately in U.S. dollars, and energy costs. In accordance with its foreign exchange risk management program, the Company manages its exposure to these risks through the use of financial instruments. The Company also uses interest rate swaps to reduce its exposure to long-term fixed interest rates associated with its senior notes. The Company does not enter into financial instruments for speculative purposes.

On January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855, "Financial Instruments – Recognition and Measurement", and Section 3865, "Hedges". Under these new guidelines the Company records all derivatives in its balance sheet at fair value.

#### **Revenue risk management instruments**

In respect of revenues, the Company uses foreign currency options and forward contracts to sell U.S. dollars. At September 30, 2007, the Company had foreign currency options and forward contracts with a notional principal of \$563 million with major financial institutions. Changes in the fair values of derivatives that qualify and are designated as cash flow hedges are deferred and recorded as a component of "Accumulated other comprehensive income" ("AOCI") until the underlying transaction is recorded in earnings. When the hedged item affects earnings, the gain or loss is reclassified from "AOCI" to "Sales". Any ineffective portion of a hedging derivative's change in fair value and the portion that is excluded from the assessment of hedge effectiveness is recognized immediately in "Sales". At September 30, 2007, instruments having a notional principal of US\$387 million are designated as hedging instruments. At period-end exchange rates, these instruments are reported at their fair value, which was \$49.8 million at the end of the third quarter of 2007.

At September 30, 2007, commodity swap agreements were outstanding to fix the sales price on NBSK pulp for 21,000 metric tonnes within the next 12 months at a weighted average PIX price of US\$792 per tonne. These contracts are not designated as hedging instruments for accounting purposes and are reported at their fair value, which was negative \$1.2 million at the end of the third quarter of 2007.

#### **Long-term debt risk management instruments**

In respect of long-term debt, the Company is party to US\$227 million at September 30, 2007, up from US\$172 million at June 30, 2007, in forward foreign exchange contracts and options to acquire U.S. dollars over a seven-year period. These instruments are not designated as hedging instruments for accounting purposes, and are included in "Other long-term obligations" on the balance sheet at their fair value. Settlements and changes in fair value are recognized in earnings as "Foreign exchange gain (loss) on long-term debt". At period-end exchange rates, these instruments are reported at their fair value, which was negative \$9.8 million at the end of the third quarter of 2007.

#### **Cost risk management instruments**

To hedge against the effect of energy cost fluctuations, the Company enters into contracts to fix the price of a portion of the Company's oil and gas requirements. The contracts are not designated as hedging instruments for accounting purposes and are reported on the balance sheet at their fair value. Settlements and changes in fair value are recognized in "Cost of sales". At period-end contract rates, these instruments are reported at their fair value, which was negative \$0.7 million at the end of the third quarter of 2007.

#### **Interest rate swaps**

The Company occasionally uses interest rate swap contracts to manage its net exposure to interest rate changes. At September 30, 2007, the Company had pay-floating, receive-fixed interest rate swap contracts for notional US\$80 million, and has designated them as hedging instruments. These derivatives are recorded on the balance sheet at their fair value. The effective portion of changes in the fair value of the derivatives are netted in "Long-term debt" and the ineffective portion is recognized in "Interest expense". The Company will receive a fixed rate of 7.375%, and pay a floating rate averaging U.S. six-month LIBOR plus 2.0%. At period-end swap rates, these instruments are reported at their fair value, which was \$1.4 million at the end of the third quarter of 2007.

#### 4 RELATED PARTY TRANSACTIONS

There were no related party transactions in the current period.

#### 5 GUARANTEES AND INDEMNITIES

The Company has provided certain indemnities with regard to several business dispositions covering potential environmental, tax and employment liabilities. A description of these indemnities and guarantees and their impact on the Company's results of operations and financial position for the year ended December 31, 2006, can be found on page 43 of the Company's 2006 Annual Report. These have not changed materially since December 31, 2006. The Company has reviewed the indemnities and guarantees under the new CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement", and has determined the fair value on these indemnities and guarantees to be insignificant.

#### 6 CONTRACTUAL OBLIGATIONS

In the normal course of business, the Company enters into certain contractual obligations related to long-term debt, and both capital and operating leases. The summary of the Company's contractual obligations as at December 31, 2006 can be found on page 39 of the Company's 2006 Annual Report. During the quarter, there were no material changes in the contractual obligations that are outside the ordinary course of the Company's business.

#### 7 SUMMARY OF QUARTERLY RESULTS

The following table highlights selected financial information for the eight consecutive quarters ending September 30, 2007:

	Q3	07 Q2	Q1	Q4	Q3	06 Q2	Q1	05 Q4
(In millions of dollars, except per share amounts)								
Sales	\$ 413.7	\$ 441.8	\$ 478.1	\$ 470.6	\$ 486.0	\$ 469.6	\$ 456.3	\$ 471.9
EBITDA <sup>1</sup>	(0.3)	(1.9)	14.1	48.5	62.8	52.4	47.3	48.3
Net earnings (loss)	(18.6)	0.2	(25.6)	(37.2)	2.5	42.4	(23.6)	(8.0)
Net earnings (loss) per share – basic and diluted	\$ (0.09)	\$ 0.00	\$ (0.12)	\$ (0.17)	\$ 0.01	\$ 0.20	\$ (0.11)	\$ (0.04)

<sup>1</sup> EBITDA is a non-GAAP measure. Refer to Section 8 "Non-GAAP Measures" for further details.

The following table reconciles the average spot exchange rate to the effective rate for the eight consecutive quarters ending September 30, 2007:

<i>US\$/CDN\$ foreign exchange</i>	<b>Q3</b>	<b>07</b> Q2	Q1	Q4	Q3	<b>06</b> Q2	Q1	<b>05</b> Q4
Average spot rate	<b>0.957</b>	0.911	0.854	0.878	0.892	0.892	0.866	0.852
Revaluation of U.S. dollar working capital	<b>0.040</b>	0.051	0.006	(0.023)	(0.001)	0.022	(0.001)	(0.005)
Impact of hedging	<b>(0.053)</b>	(0.035)	(0.002)	0.018	(0.006)	(0.037)	(0.010)	(0.016)
Other	<b>(0.009)</b>	(0.011)	0.002	0.005	0.001	(0.005)	(0.002)	(0.002)
Effective rate	<b>0.935</b>	0.916	0.860	0.878	0.886	0.872	0.853	0.829

## 8 NON-GAAP MEASURES

EBITDA (earnings before interest, taxes, depreciation and amortization and before other non-operating income and expenses), as defined equates to operating earnings (loss) plus amortization. As Canadian GAAP does not define a method of calculating EBITDA, the measure as calculated by the Company might not be comparable to similarly-titled measures reported by other entities. The Company focuses on EBITDA, as the Company believes this measure enables comparison of its results between periods without regard to debt service, income taxes, and capital expenditure requirements. As such, the Company believes it would be useful for investors and other users to be aware of this measure so they can better assess the Company's operating performance. EBITDA should not be considered by an investor as an alternative to net earnings, an indicator of the financial performance of the Company, or an alternative to cash flows as a measure of liquidity.

The Company incurred some specific items in 2007 and 2006 that adversely or positively affected its average delivered cash costs per tonne, EBITDA, operating earnings (loss), and net earnings (loss), making the comparison of results difficult from period to period. The Company believes it is useful for readers to be aware of these items as it provides an indication of performance and comparative trends, excluding these specific items. Specific items include foreign exchange gain or loss on long-term debt, asset impairments, restructuring and change-of-control costs, financing related fees, income tax adjustments, the impact of significant labour disruptions, and other significant items of an unusual or non-recurring nature. The Company believes this is useful supplemental information, however, the Company's measures excluding specific items have no standardized meaning under Canadian GAAP and might not be comparable to similarly-titled measures reported by other entities. Readers should be cautioned that average delivered cash costs per tonne before specific items, EBITDA before specific items, EBITDA margin before specific items, net earnings (loss) before specific items and net earnings (loss) per share before specific items should not be confused with or used as an alternative to measures prescribed by Canadian GAAP.

Refer to the tables below for a reconciliation of net earnings (loss) to EBITDA and EBITDA before specific items, the impact of specific items by segment, and a reconciliation of net earnings (loss) as reported to net earnings (loss) before specific items.

**Reconciliation of net earnings to EBITDA and EBITDA before specific items**

	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
<i>(In millions of dollars)</i>									
Net earnings (loss)	\$ (44.0)	\$ <b>(18.6)</b>	\$ 0.2	\$ (25.6)	\$ (15.9)	\$ (37.2)	\$ 2.5	\$ 42.4	\$ (23.6)
Amortization	133.6	<b>44.0</b>	44.8	44.8	183.7	46.0	45.8	46.3	45.6
Impairment loss on property, plant and equipment	–	–	–	–	23.4	5.8	–	–	17.6
Foreign exchange (gain) loss on long-term debt	(95.0)	<b>(33.9)</b>	(53.2)	(7.9)	0.3	31.6	(0.1)	(31.6)	0.4
Other (income) expense, net	8.7	<b>7.2</b>	1.8	(0.3)	(1.8)	(1.7)	0.4	(0.5)	–
Interest expense, net	55.3	<b>18.4</b>	18.4	18.5	73.8	18.3	18.4	18.7	18.4
Income tax expense (recovery)	(46.8)	<b>(17.4)</b>	(14.2)	(15.2)	(54.0)	(13.8)	(4.4)	(24.4)	(11.4)
Non-controlling interest	0.1	<b>0.0</b>	0.3	(0.2)	1.5	(0.5)	0.2	1.5	0.3
EBITDA	11.9	<b>(0.3)</b>	(1.9)	14.1	211.0	48.5	62.8	52.4	47.3
Specific items:									
Restructuring costs	53.9	<b>24.1</b>	19.0	10.8	–	–	–	–	–
Change-of-control costs	8.8	<b>0.3</b>	0.3	8.2	–	–	–	–	–
Impact of USW strike	13.3	<b>13.3</b>	–	–	–	–	–	–	–
EBITDA before specific items	\$ 87.9	\$ <b>37.4</b>	\$ 17.4	\$ 33.1	\$ 211.0	\$ 48.5	\$ 62.8	\$ 52.4	\$ 47.3

**Impact of specific items by segment**

	YTD	Q3	07	
			Q2	Q1
(In millions of dollars, except where otherwise stated)				
Sales	\$ (25.7)	\$ (25.7)	\$ –	\$ –
Cost of sales	12.4	12.4	–	–
Impact of the USW strike <sup>1</sup>	(13.3)	(13.3)	–	–
Restructuring costs	(53.9)	(24.1)	(19.0)	(10.8)
Change-of-control costs	(8.8)	(0.3)	(0.3)	(8.2)
EBITDA impact of specific items	\$ (76.0)	\$ (37.7)	\$ (19.3)	\$ (19.0)
Segment EBITDA – favourable (unfavourable)				
Impact of specific items				
Specialty paper	\$ (43.6)	\$ (17.6)	\$ (12.9)	\$ (13.1)
Newsprint	(15.4)	(7.7)	(4.0)	(3.7)
Pulp	(17.0)	(12.4)	(2.4)	(2.2)
Total	\$ (76.0)	\$ (37.7)	\$ (19.3)	\$ (19.0)
Lost sales due to USW strike (000 tonnes)				
Specialty paper	2.8	2.8	–	–
Newsprint	20.6	20.6	–	–
Pulp	17.2	17.2	–	–
Total	40.6	40.6	–	–
Curtailed production due to USW strike (000 tonnes)				
Specialty paper	3.2	3.2	–	–
Newsprint	33.1	33.1	–	–
Pulp	27.9	27.9	–	–
Total	64.2	64.2	–	–

<sup>1</sup> The impact of the USW strike is based on management estimates. There were no significant restructuring and change-of-control costs or USW strike related costs in 2006.

**Reconciliation of net earnings (loss) as reported to net earnings (loss) before specific items**

	YTD	07 Q3	Q2	Q1	TOTAL	Q4	06 Q3	Q2	Q1
<small>(In millions of dollars and after-tax, except where otherwise stated)</small>									
Net earnings (loss)									
as reported	\$ (44.0)	\$ (18.6)	\$ 0.2	\$ (25.6)	\$ (15.9)	\$ (37.2)	\$ 2.5	\$ 42.4	\$ (23.6)
Specific items (after taxes):									
Foreign exchange loss (gain)									
on long-term debt	(78.8)	(28.1)	(44.1)	(6.6)	0.2	26.2	(0.1)	(26.2)	0.3
Impairment loss	–	–	–	–	15.4	3.8	–	–	11.6
Loss on sale of A3 paper machine	4.9	4.9	–	–	–	–	–	–	–
Restructuring and change-of-control costs	41.3	16.1	12.7	12.5	–	–	–	–	–
USW strike impact	8.8	8.8	–	–	–	–	–	–	–
Third Avenue Management tender offer	–	–	–	–	2.2	–	2.2	–	–
Financing related fees	0.8	–	0.8	–	–	–	–	–	–
Income tax adjustments	(1.4)	–	(1.4)	–	(26.9)	–	(4.0)	(22.9)	–
Net earnings (loss) before specific items	\$ (68.4)	\$ (16.9)	\$ (31.8)	\$ (19.7)	\$ (25.0)	\$ (7.2)	\$ 0.6	\$ (6.7)	\$ (11.7)
Net earnings (loss) per share in dollars:									
As reported	\$ (0.20)	\$ (0.09)	\$ 0.00	\$ (0.12)	\$ (0.07)	\$ (0.17)	\$ 0.01	\$ 0.20	\$ (0.11)
Before specific items	\$ (0.32)	\$ (0.08)	\$ (0.15)	\$ (0.09)	\$ (0.12)	\$ (0.03)	\$ 0.00	\$ (0.03)	\$ (0.06)

## 9 CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with Canadian GAAP requires companies to establish accounting policies and to make estimates that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses. Some of these estimates require judgments about matters that are inherently uncertain.

On an ongoing basis, management reviews its estimates, including those related to environmental and legal liabilities, impairment of long-lived assets, pension and post-retirement benefits, provision for bad and doubtful accounts and income taxes based upon currently available information. Actual results could differ from those estimates. The discussion on the accounting policies that require management's most difficult, subjective and complex judgments, and which are subject to a fair degree of measurement uncertainty can be found on pages 46 to 50 of the Company's 2006 Annual Report. These have not materially changed since December 31, 2006.

## 10 CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the Company adopted the following new pronouncements issued by the CICA:

### *Section 1530, "Comprehensive Income"*

Section 1530, "Comprehensive Income", defines and establishes the reporting requirements for comprehensive income.

### *Section 3251, "Equity"*

Section 3251, "Equity", replaces Section 3250, "Surplus", and establishes standards for the presentation of changes in equity.

### *Section 3855, "Financial Instruments – Recognition and Measurement"*

Section 3855, "Financial Instruments – Recognition and Measurement", establishes the requirements for the recognition and measurement of financial assets, financial liabilities and non-financial derivatives.

### *Section 3861, "Financial Instruments – Disclosure and Presentation"*

Section 3861, "Financial Instruments – Disclosure and Presentation", replaces Section 3860, "Financial Instruments – Disclosure and Presentation", and establishes the requirements for presentation and disclosure of financial instruments and non-financial derivatives.

### *Section 3865, "Hedges"*

Section 3865, "Hedges", establishes the standards for when and how hedge accounting may be applied.

## 11 IMPACT OF ACCOUNTING PRONOUNCEMENTS AFFECTING FUTURE PERIODS

In June 2007, the CICA issued a new accounting standard that impacts the recognition, measurement and disclosure of inventories. Section 3031, "Inventories" replaces Section 3030, "Inventories", and establishes standards for the determination of cost and its subsequent recognition as an expense.

The new section is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company is currently in the process of evaluating the impact of the new accounting standard on the Company's financial position, results of operations and cash flows.

## 12 RISKS AND UNCERTAINTIES

The Company produces and markets paper and pulp products that are sold globally. The Company seeks to differentiate its product lines from those of other producers by supplying specialty products that add value for customers. However, like most companies in the forest products industry in North America, the Company faces business risks and uncertainties. These fall into the general business areas of markets, international commodity prices, currency exchange rates, environmental issues, fibre supply, government regulation and policy, and for Canadian companies, trade barriers and potential impacts of Aboriginal rights, including unresolved Aboriginal land claims in British Columbia.

In order to address these risks and effectively manage them, the Company's management has developed a process for managing risk and the interrelationships risks have with the Company's strategic plan. Management provides regular updates to the Audit Committee, works with corporate and operational management to identify, measure, and prioritize the critical risks facing the Company, and manages these risks by ensuring that they are adequately addressed through mitigating procedures where appropriate. The objectives of the risk management function include developing a common framework for understanding what constitutes principal business risks, ensuring that risk management activities are aligned with business strategies, and providing an effective mechanism for governance in the area of risk management.

A discussion of the principal uncertainties to which the Company is subject follows.

### ***Product prices***

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The Company's markets are commodity-based and cyclical in nature. Markets for the principal products are affected by fluctuations in supply and demand within each cycle, which in turn affect product prices. Demand has historically been determined by the level of economic growth and has been very closely tied to overall business activity and personal income. The Company's earnings are sensitive to price changes for its principal products, with the effect of price changes on specialty and newsprint grades being the greatest.

The newsprint market is mature, but the Company believes it remains in a position to mitigate the impact of this decline through its ability to switch grades.

### ***Global competition***

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Pulp and paper markets are highly competitive global commodity markets in which producers compete primarily on the basis of price. A majority of the Company's production is directed to markets outside Canada, where Canadian producers generally compete with American, European and Asian producers. Many of the Company's competitors are larger and have greater financial resources than the Company and some of the mills operated by the Company's competitors are lower cost producers than the mills the Company operates.

### ***International sales***

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A significant portion of the Company's sales are outside Canada and the United States. Therefore, the Company faces a number of risks including tariffs and other trade barriers, unfavourable business conditions or political and economic instability in foreign markets, fluctuations in foreign currencies, and difficulty in obtaining distribution and support.

Under the terms of the Company's distribution agreement relating to the sale of paper, either party on six-months' notice may terminate the agreement. If the agreement is terminated, the Company will be required to replace the distributor within the six-month notice period in order to minimize disruption to sales activities in the relevant market.

### **Foreign exchange**

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The Company's profitability is subject to fluctuations in foreign currencies, particularly the U.S. dollar. Nearly all of the Company's sales are in U.S. dollars, while a substantial portion of the Company's costs and expenses are incurred, and results of operations and financial conditions are reported, in Canadian dollars. The value of the Canadian dollar in relation to the U.S. dollar has increased significantly in recent years. Further increases in the value of the Canadian dollar relative to the U.S. dollar would reduce the amount of revenue in Canadian dollar terms realized by the Company on sales made in U.S. dollars.

Fluctuations in foreign currencies affect the Company's competitive position in world markets. Apart from the value of the Canadian dollar relative to the U.S. dollar, the Company's competitiveness in world markets is affected by the relative strength of the currencies of other producing countries. The Company is also exposed to currency exchange risk on debt denominated in U.S. dollars, including its 7.375% and 8.625% senior notes.

Under a Board-approved foreign exchange risk management program, the Company manages a portion of its currency exposure through the use of currency options and forward contracts to hedge anticipated future sales denominated in foreign currencies and U.S.-dollar-denominated debt. The Company's hedging policy for revenues includes 33% to 67% of 0- to 12-month and 0% to 25% of 13- to 24-month U.S. dollar net exposure. The revenue hedge program mitigates the impact of any rapid movements in currency by 20% to 40% over the near term. In addition, the Company considers future U.S. dollar revenues to provide a partial natural hedge for its U.S.-dollar-denominated debt.

### **Fibre supply**

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Since the Company has no significant timber holdings, operations are dependent on the supply by third parties of wood fibre. Approximately 46% of the Company's fibre needs are provided by five suppliers. The Company's fibre supply could be reduced as a result of events beyond its control, such as industrial disputes, natural disasters, material curtailments, and shutdown of operations by suppliers or the Company for market or other reasons. Market-related curtailments or shutdowns can be influenced by both seasonal and cyclical factors such as raw material availability, finished goods inventory levels, or interest rates and underlying demand for lumber in key markets.

Long-term fibre contracts with third parties are conducted at market prices or at prices determined under market-based formulas and represent approximately 65% of the Company's pulp and paper mills' wood fibre requirements. The solid wood segment of British Columbia's forest industry has undergone significant consolidation and downsizing. As a result, there is no assurance that the Company will continue to be able to access wood fibre at the same levels achieved in the past; therefore, costs may be negatively impacted.

The Company is currently monitoring the impacts of the softwood lumber agreement and the weak U.S. housing market to determine British Columbia's lumber producers' ability to maintain production levels. The Company's cost and availability of wood fibre could be negatively impacted if its wood fibre suppliers are forced to alter their operations such that they are not able to supply wood fibre to the Company at current levels or from cost-effective locations or due to a decline in market conditions that make it uneconomical for the supplier to operate.

The current infestation of the mountain pine beetle in the interior of British Columbia is expected to affect the long-term fibre supply in that region. The beetle attacks lodgepole pine forests and once attacked, pine trees typically die within the year. Approximately 30% of the Company's fibre supply comes from the British Columbia interior and it is used primarily by the Powell River paper mill and Crofton kraft pulp mill. In three to five year's time, the infestation could have a significant impact on the availability and cost of fibre used by those mills.

In addition, government regulations and aboriginal issues may also lower the supply of wood fibre. The Province of British Columbia owns approximately 95% of all timberlands and could introduce legislation to reduce wood fibre supply. Aboriginal groups have claimed aboriginal title over substantial portions of British Columbia's timberlands, including areas where the forest tenures held by the Company's suppliers are located. Although the renewal of forest tenures held by the Company's suppliers may be adversely impacted by claims of aboriginal title, the specific impact cannot be estimated at this time.

The Company is also a large consumer of old newspapers and magazines. Ownership of Western Canada's largest paper recycling facility enables the Company to secure 100% of its recycled fibre needs from this facility. While the supply remains reliable, the pricing is determined by the market and is subject to variability. Demand and prices for old newspapers have been increasing in recent periods due primarily to increased export demand.

### ***Labour disruptions***

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Approximately three quarters of the Company's pulp and paper mill employees are members of the Communications, Energy & Paperworkers Union of Canada ("CEP"), the Pulp, Paper and Woodworkers of Canada ("PPWC") or the Canadian Office and Professional Employees Union ("COPE") unions. Collective agreements with the CEP and PPWC unions expire in April 2008. During Q1, 2006, the Company negotiated a new collective agreement with COPE, the smallest of the three unions, that expires on April 30, 2012. Distribution centre employees are members of the Christian Labour Association of Canada ("CLAC") and nine employees at the Port Alberni operations are members of the Office and Technical Employees Union ("OTEU"). The collective agreement with CLAC and OTEU both expire in April 2012. The Company believes its labour relations are strong and does not anticipate labour disruptions in its operations. However, the Company may not be able to negotiate an acceptable contract with any of the Company's unions upon expiration of these existing contracts. This could result in a strike or work stoppage by the affected workers. Renewal of contracts could result in higher wages or benefits paid to union members. Therefore, the Company could experience a significant disruption of its operations or higher ongoing labour costs, which could have a material adverse effect on the business, financial condition, results of operations and cash flow.

Many of the Company's suppliers and service providers are unionized. Strikes or work stoppages by members of those unions could result in a significant disruption of operations or higher operating costs, which could have a material adverse effect on the business.

Negotiations between the B.C. Maritimes Employers' Association ("BCMEA") and the International Longshoremen Workers' Union ("ILWU") have failed to reach a labour agreement to date. The federal government appointed two conciliators to meet with the parties on October 19 and prepare recommendations within 60 days. No strike or lockout can occur within 21 days of the Minister of Labour receiving the report. No labour disruption can be expected before January 2008. In event of a work stoppage, there would be an interruption to our sales to international customers.

### **Aboriginal claims**

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The Company's ability to operate its manufacturing facilities may also be affected by aboriginal groups' claims of aboriginal title and rights. The governments of Canada and British Columbia have established a formal process to negotiate settlements with aboriginal groups throughout British Columbia in order to resolve these land claims. It is the policy of the governments that ownership of lands held in fee simple by third parties such as the Company will not be affected by treaty negotiations. In the case of the Powell River mill, the site has been included in areas to which an aboriginal group has asserted aboriginal title both through treaty negotiations with government and by commencing an action in the Supreme Court of British Columbia. While the Company and other industrial companies have been named as parties in the court proceeding along with the two governments of Canada and British Columbia, counsel for the aboriginal group has advised the Company that the plaintiffs are currently negotiating with two governments and have no intention of proceeding with the action at this time. Based on the history of similar proceedings, the Company expects that it would take many years before a final court decision could be rendered if the court proceeding were pursued.

Recent Supreme Court of Canada decisions have confirmed that the governments of Canada and British Columbia are obligated to consult with and, in certain circumstances, accommodate aboriginal groups whenever there is a reasonable prospect their decisions, such as the decision to issue or amend a regulatory permit, may affect aboriginal groups' rights or title. This duty of consultation and accommodation may affect the Company's ability to obtain or amend necessary regulatory permits on a timely basis and may influence the conditions set out in such permits. In mid-2005 the Government of British Columbia initiated a "new relationship" policy related to Aboriginal interests that recognizes the need to find pre-treaty solutions to advance the consultation process and to reconcile governmental interests and Aboriginal interests. This new relationship policy is directed, in part, at improving decision-making affecting land and resource use. It is unclear what, if any, impact the new relationship policy will have on governmental decision making as it affects the Company.

### **Energy costs**

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The Company is a significant consumer of electrical power.

The Company's electricity supply contracts are provincially regulated, and historically pricing has been very stable. The regulatory commission of the British Columbia Hydro and Power Authority ("BC Hydro"), approved an increase of 1.64% over BC Hydro's rate prior to July 2006, effective February 1, 2007 and is charging an additional rate rider of 2% on all customer bills for the period February 1, 2007 to March 31, 2008. The Company believes that the Province's electricity rates will continue to be low relative to other regions in North America, but going forward BC Hydro will be requesting rate increases on a more regular basis than in the past should the cost of their electricity sources continue to rise. Consequently, future changes in electricity prices could have a significant impact on the Company's earnings.

The majority of the Company's fossil fuels, particularly oil and natural gas, are purchased on the spot market, which can fluctuate significantly depending on various external factors.

A portion of the Company's exposure to fluctuating fossil fuel prices is managed through the use of financial instruments and physical supply contracts, under a Board-approved energy program. The Company's energy hedging policy is restricted to 10-70% of the net exposure for oil and gas. In addition, the Company reduces its exposure to fossil fuel prices through the use of lower priced alternatives.

Freight charges and chemical expenses also vary with oil and diesel fuel prices.

### **Legal proceedings**

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In the ordinary course of business, the Company occasionally will become party to legal proceedings, which are generally related to contract disputes and employment law. As at September 30, 2007, the final results of currently ongoing legal proceedings, while not immediately determinable, are not expected to have a material effect on financial results.

### **Prior period losses**

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The Company has recorded a net loss in 7 of the last 12 quarters. These losses have arisen primarily as a result of the strengthening Canadian dollar and, to a lesser extent, market conditions. Should the Canadian dollar continue to strengthen, or should market conditions deteriorate to a greater extent, the Company may, over time, need to rely to a greater extent on its Facility and, if necessary, additional sources of funding.

In particular, the Company's pulp operations face significant challenges with the strong Canadian dollar and the cost of fibre. While under current market projections the Company expects to operate its pulp facilities, deterioration in market conditions or unplanned major capital expenditures may necessitate temporary or permanent curtailment.

### **Debt**

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The Company has a significant amount of debt, and its debt agreements contain various restrictive and financial covenants. The Company's ability to pay interest on and satisfy its debt obligations will depend on its future operating performance and ability to obtain additional debt or equity financing when necessary. Prevailing economic conditions and financial, business and other factors beyond the Company's control may affect its ability to make these payments. In addition, the Company's debt level may limit its ability to obtain additional financing and increase its vulnerability to interest rate fluctuations. Should the challenging market conditions continue, the Company may, over time, have to rely to a greater extent on its Facility and, if necessary, additional sources of funding.

### **Environmental matters**

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The Company's operations are subject to a wide range of general and industry-specific environmental laws and regulations related to waste management. The costs of compliance with such laws and regulations can be significant. The Company could also incur significant costs, such as civil or criminal fines, sanctions and enforcement actions (including orders requiring remedial actions) and third party claims for property damage and personal injury, as a result of violations of, or liabilities under, environmental laws and regulations. The Company continually monitors its environmental performance and believes that its facilities are operating in substantial compliance with environmental laws and regulations.

The federal government has recently indicated its intent to regulate priority air pollutants and greenhouse gases under the Clean Air Act. The forest products sector is named as one of the targeted sectors for regulation. The impact and associated cost of any such regulation is currently unknown, although it is anticipated that the government will consult with industry before finalizing any regulations.

### 13 OUTLOOK

The Company expects a number of factors to have a positive impact on results for the fourth quarter including the realization of benefits from workforce reductions, lower restructuring costs, price increases in a number of products and the indefinite closure of the A4 paper machine in September 2007. The Company expects the strength of the Canadian dollar to continue to present a significant challenge for the Canadian pulp and paper industry but it is also providing impetus for capacity curtailment. The Company expects to have substantially completed its restructuring program by the end of Q4.

The agreement between the FIR group and the USW was ratified by approximately 51% of the relevant membership on October 21, 2007. Of the Company's 42% affected fibre supply base, approximately three-quarters relates to suppliers who are members of FIR. The other affected companies are currently in negotiations with the USW to reach an agreement. Barring unforeseen circumstances, forestry operations are expected to return to normal during November allowing the Company to rebuild fibre inventory levels through the balance of the quarter. The strike is expected to impact the Company's production in the fourth quarter by approximately 100,000 tonnes, approximately 70% paper, principally newsprint, and approximately 30% pulp, and could continue to have an impact into Q1 of 2008.

Coated mechanical prices are expected to increase in the fourth quarter as the previously announced price increases of US\$60 per ton effective July 1, 2007 and US\$60 per ton effective October 1, 2007 are being implemented. Market conditions remain tight and further price increases are expected. Uncoated mechanical market conditions are expected to improve; a US\$20 to US\$40 per ton price increase has been announced for SC and superbright grades, effective October 1, 2007. The directory market is expected to remain firm during the fourth quarter.

Newsprint demand is expected to remain weak. As a result of the high Canadian dollar and cost pressures, a US\$25 per tonne price increase was announced for October 1, 2007 and has been deferred to November 1, 2007.

NBSK pulp market fundamentals remain positive in the near term. A US\$20 per tonne price increase has been announced in Europe, effective November 1, 2007. The market for containerboard (including white-top linerboard) is expected to remain balanced due to steady mill and box inventories.

Capital spending will continue to be directed toward high return projects and is expected to be approximately \$90 million for 2007. The Company has spent \$68 million to the end of the third quarter.

#### 14 DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

The Company did not make any significant changes in internal control over financial reporting during the most recent interim period ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company's Audit Committee, as part of its oversight role, has reviewed and recommended the approval of this MD&A to the board of directors. The board of directors has read and approved this MD&A. Through discussions with management, the board of directors and the Audit Committee have satisfied themselves that management has implemented the necessary disclosure controls.

A summary of the Company's regulatory requirements with respect to the evaluation of internal controls and subsequent reporting of the results of that evaluation can be found on pages 58 to 59 of the Company's 2006 Annual Report. There have been no significant changes to those requirements since December 2006.

#### 15 OUTSTANDING SHARE DATA

At September 30, 2007, the Company had 214,684,129 common shares issued and outstanding.

Additional information about the Company including the 2006 Annual Information Form is available on the Company's website at [www.catalystpaper.com](http://www.catalystpaper.com), or the Canadian Securities Administrator's electronic filing website at [www.sedar.com](http://www.sedar.com).

## Consolidated statements of earnings

	Three months ended September 30,		Nine months ended September 30,	
	07	06	07	06
(Unaudited and in millions of Canadian dollars, except where otherwise stated)				
Sales	\$ 413.7	\$ 486.0	\$ 1,333.6	\$ 1,411.9
Operating expenses				
Cost of sales	379.1	405.5	1,221.6	1,201.6
Selling, general and administrative	10.5	17.7	37.4	47.8
Restructuring and change-of-control	24.4	–	62.7	–
Amortization	44.0	45.8	133.6	155.3
	458.0	469.0	1,455.3	1,404.7
<b>Operating earnings (loss)</b>	<b>(44.3)</b>	17.0	<b>(121.7)</b>	7.2
Interest expense, net	(18.4)	(18.4)	(55.3)	(55.5)
Foreign exchange gain on long-term debt	33.9	0.1	95.0	31.3
Other income (expense), net (note 4)	(7.2)	(0.4)	(8.7)	0.1
<b>Earnings (loss) before income taxes and non-controlling interest</b>	<b>(36.0)</b>	(1.7)	<b>(90.7)</b>	(16.9)
Income tax expense (recovery)				
Current	0.5	0.5	0.5	2.3
Future (note 5)	(17.9)	(4.9)	(47.3)	(42.5)
	(17.4)	(4.4)	(46.8)	(40.2)
<b>Net earnings (loss) before non-controlling interest</b>	<b>(18.6)</b>	2.7	<b>(43.9)</b>	23.3
Non-controlling interest	–	(0.2)	(0.1)	(2.0)
<b>Net earnings (loss)</b>	<b>\$ (18.6)</b>	\$ 2.5	<b>\$ (44.0)</b>	\$ 21.3
Other comprehensive income (note 2)	\$ 10.8	\$ –	\$ 22.8	\$ –
<b>Comprehensive income (loss)</b>	<b>\$ (7.8)</b>	\$ 2.5	<b>\$ (21.2)</b>	\$ 21.3
Basic and diluted earnings (loss) per share (in dollars)	\$ (0.09)	\$ 0.01	\$ (0.20)	\$ 0.10
Weighted average common shares outstanding (in millions)	214.7	214.6	214.7	214.6

## Consolidated balance sheets

	<b>September 30, 2007</b>	<i>December 31, 2006</i>
(In millions of Canadian dollars)	(Unaudited)	
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ —	\$ 35.5
Accounts receivable	229.1	277.9
Inventories	245.1	245.0
Prepays and other	63.7	15.4
	<b>537.9</b>	573.8
Property, plant and equipment (note 7)	1,946.1	2,023.1
Other assets	33.1	40.8
	<b>\$ 2,517.1</b>	\$ 2,637.7
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 268.1	\$ 293.3
Long-term debt (note 8)	799.8	854.5
Employee future benefits (note 9)	194.4	187.2
Other long-term obligations	39.9	27.5
Future income taxes	205.4	243.9
Deferred credits	25.3	25.5
	<b>1,532.9</b>	1,631.9
<b>Shareholders' equity</b>		
Share capital	913.9	913.6
Contributed surplus	11.6	9.3
Retained earnings	36.6	82.9
Accumulated other comprehensive income (note 2)	22.1	—
	<b>984.2</b>	1,005.8
	<b>\$ 2,517.1</b>	\$ 2,637.7

On behalf of the Board:

[Signed]

*Richard Garneau*  
Director

[Signed]

*Thomas S. Chambers*  
Director

### Consolidated statements of shareholders' equity and comprehensive income

		<i>Share capital</i>	<i>Contributed</i>	<i>Retained</i>	<i>Accumulated</i>	<i>Total</i>
	<i>#</i>	<i>\$</i>	<i>surplus</i>	<i>earnings</i>	<i>other</i>	<i>shareholders'</i>
					<i>comprehensive</i>	<i>equity</i>
					<i>income (loss)</i>	
<i>(In millions of dollars, except where otherwise stated)</i>						
Balance,						
December 31, 2006	214,604,120	\$ 913.6	\$ 9.3	\$ 82.9	\$ –	<b>\$ 1,005.8</b>
Adoption of new accounting standards (note 2)	–	–	–	(2.3)	(0.7)	<b>(3.0)</b>
Adjusted balance,						
January 1, 2007	214,604,120	913.6	9.3	80.6	(0.7)	<b>1,002.8</b>
Stock options exercised	80,009	0.3	–	–	–	<b>0.3</b>
Stock option compensation expense	–	–	2.3	–	–	<b>2.3</b>
Comprehensive income (loss):						
Net earnings (loss)	–	–	–	(44.0)	–	<b>(44.0)</b>
Change in unrealized net gain on cash flow hedges related to revenue, net of tax of \$13.7 million	–	–	–	–	26.5	<b>26.5</b>
Reclassification of net gain on cash flow hedges related to revenue included in net loss, net of tax of \$1.9 million	–	–	–	–	(3.7)	<b>(3.7)</b>
Total comprehensive income (loss)	–	–	–	(44.0)	22.8	<b>(21.2)</b>
Balance,						
September 30, 2007	214,684,129	\$ 913.9	\$ 11.6	\$ 36.6	\$ 22.1	<b>\$ 984.2</b>

## Consolidated statements of cash flows

	Three months ended September 30,		Nine months ended September 30,	
	07	06	07	06
(Unaudited and in millions of Canadian dollars)				
<b>Cash flows provided (used) by</b>				
<b>Operating</b>				
Net earnings (loss)	\$ (18.6)	\$ 2.5	\$ (44.0)	\$ 21.3
Items not requiring (providing) cash				
Amortization	44.0	45.8	133.6	137.7
Impairment loss on property, plant and equipment	–	–	–	17.6
Future income taxes	(17.9)	(4.9)	(47.3)	(42.5)
Employee future benefits, excess of expense over funding	4.2	1.4	7.3	4.2
Increase in other long-term obligations	6.5	2.7	7.1	0.8
Foreign exchange gain on long-term debt	(33.9)	(0.1)	(95.0)	(31.3)
Non-controlling interest	–	0.2	0.1	2.0
Loss on sale of property, plant and equipment	7.4	–	7.4	–
Other	(9.5)	(7.4)	(25.1)	(14.9)
	(17.8)	40.2	(55.9)	94.9
Changes in non-cash operating working capital				
Accounts receivable	22.7	(24.4)	48.8	(18.9)
Inventories	8.0	(3.5)	(0.1)	4.1
Prepays and other	(11.7)	(12.1)	(12.8)	(9.8)
Accounts payable and accrued liabilities	(35.3)	12.6	(17.2)	13.5
	(16.3)	(27.4)	18.7	(11.1)
Cash flows provided (used by) operating activities	(34.1)	12.8	(37.2)	83.8
<b>Investing</b>				
Additions to property, plant and equipment	(25.0)	(22.9)	(68.3)	(52.2)
Proceeds from sale of property, plant and equipment	3.6	–	4.5	1.0
Purchase price adjustment	–	4.3	–	4.3
Decrease (increase) in other assets	(2.3)	(0.2)	(2.1)	0.7
Cash flows used by investing activities	(23.7)	(18.8)	(65.9)	(46.2)
<b>Financing</b>				
Issuance of shares	–	–	0.4	–
Increase (decrease) in revolving loan	58.2	–	67.6	(6.5)
Decrease in other long-term obligations	(0.4)	–	(0.4)	–
Cash flows provided (used by) financing activities	57.8	–	67.6	(6.5)
Cash and cash equivalents, increase (decrease) during period	–	(6.0)	(35.5)	31.1
Cash and cash equivalents, beginning of period	–	37.1	35.5	–
<b>Cash and cash equivalents, end of period</b>	\$ –	\$ 31.1	\$ –	\$ 31.1

## Consolidated statements of cash flows (continued)

	Three months ended September 30, 07		Nine months ended September 30, 06	
(Unaudited and in millions of Canadian dollars)				
<b>Supplemental information</b>				
Income taxes paid (received)	\$ (0.2)	\$ (0.1)	\$ 0.6	\$ 2.9
Net interest paid	17.9	17.7	52.7	54.1

## Consolidated business segments

Three months ended September 30, 2007	Specialty paper	Newsprint	Pulp	Total
(Unaudited and in millions of Canadian dollars)				
Sales <sup>1</sup>	\$ 222.1	\$ 77.8	\$ 113.8	\$ 413.7
Amortization	26.3	7.5	10.2	44.0
Operating earnings (loss)	(26.3)	(15.6)	(2.4)	(44.3)
Additions to property, plant and equipment	9.9	10.6	4.5	25.0

### Three months ended September 30, 2006

Sales <sup>1</sup>	\$ 245.0	\$ 128.8	\$ 112.2	\$ 486.0
Amortization	24.7	10.7	10.4	45.8
Operating earnings (loss)	6.9	7.5	2.6	17.0
Additions to property, plant and equipment	11.2	9.4	2.3	22.9

### Nine months ended September 30, 2007

Sales <sup>1</sup>	\$ 685.3	\$ 293.8	\$ 354.5	\$ 1,333.6
Amortization	75.3	27.0	31.3	133.6
Operating earnings (loss)	(61.6)	(42.4)	(17.7)	(121.7)
Additions to property, plant and equipment	29.2	28.9	10.2	68.3

### Nine months ended September 30, 2006

Sales <sup>1</sup>	\$ 684.4	\$ 401.4	\$ 326.1	\$ 1,411.9
Amortization	70.1	52.3	32.9	155.3
Operating earnings (loss)	16.3	5.0	(14.1)	7.2
Additions to property, plant and equipment	27.5	18.5	6.2	52.2

<sup>1</sup> Pulp sales are stated net of inter-segment pulp sales of \$11.3 million for the three months ended September 30, 2007 (\$11.8 million – three months ended September 30, 2006) and \$33.9 million for the nine months ended September 30, 2007 (\$34.4 million – nine months ended September 30, 2006).

## Notes to the consolidated financial statements

(Unaudited and in millions of dollars, except where otherwise noted)

### 1 BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and, from their respective dates of acquisition of control or formation, its wholly-owned subsidiaries and partnerships. In addition, the consolidated financial statements include the accounts of variable interest entities where it has been determined that the Company is the primary beneficiary. All inter-company transactions and amounts have been eliminated on consolidation.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") on a basis consistent with those followed in the December 31, 2006, audited annual consolidated financial statements, except as disclosed in note 2 below. These unaudited interim consolidated financial statements do not include all information and note disclosures required by GAAP for annual financial statements, and therefore should be read in conjunction with the December 31, 2006 audited consolidated financial statements and the notes thereto.

All dollar amounts referred to in the unaudited interim consolidated financial statements and the notes thereto reflect Canadian dollars unless otherwise stated.

### 2 CHANGES IN ACCOUNTING POLICIES

In April 2005, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3855, "Financial Instruments – Recognition and Measurement", Section 1530, "Comprehensive Income", Section 3865, "Hedges", Section 3861, "Financial Instruments – Disclosure and Presentation", and Section 3251, "Equity". These standards introduce new requirements for recognition, measurement and disclosure of financial instruments, when and how hedge accounting may be applied, establishes the concept of comprehensive income and rules for reporting it and establishes rules for the presentation of equity and changes in equity. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The Company adopted the new standards on January 1, 2007. Prior period financial statements are not revised for the adoption of these new standards.

The new pronouncements require an entity to account for its derivatives at fair value at each balance sheet date. The effective portion of changes in the derivative fair values that qualify and are designated as cash flow hedges is deferred and recorded as a component of "Accumulated Other Comprehensive Income (Loss)" ("AOCI"), a component of shareholders' equity, until the underlying transaction is recorded in earnings while the ineffective portion flows through net earnings. Changes in the derivative fair values that qualify and are designated as fair value hedges flow through net earnings at the same time as the hedged item. In addition, the new pronouncements also require entities to either expense deferred financing costs immediately or to net them against the carrying value of debt. The Company has opted to net its deferred financing costs against debt.

**Notes to the consolidated financial statements** (continued)  
(Unaudited and in millions of dollars, except where otherwise noted)

The adoption of these standards resulted in the Company recording on its balance sheet, at fair value, certain revenue and interest rate derivative financial instruments that were previously off balance sheet and the reclassification of its deferred financing costs against long-term debt. This resulted in the following adjustments at January 1, 2007:

<b>Assets</b>	
Prepays and other	\$ (7.8)
Other assets	(12.0)
	<b>\$ (19.8)</b>
<b>Liabilities and shareholders' equity</b>	
Accounts payable and accrued liabilities	\$ (0.2)
Long-term debt	(14.7)
Other long-term obligations	(0.2)
Future income taxes	(1.7)
Retained earnings	(2.3)
Accumulated other comprehensive income	(0.7)
	<b>\$ (19.8)</b>

### 3 CHANGE-OF-CONTROL AND RESTRUCTURING COSTS

On January 15, 2007, the Company's board of directors announced that it had accepted the resignations of Russell J. Horner, President and Chief Executive Officer, and Ralph Leverton, Vice-President, Finance and Chief Financial Officer, who had elected to exercise their Amended and Restated Change of Control Agreements. For the three months ended March 31, 2007 and nine months ended September 30, 2007, the Company recorded \$7.7 million of costs related to change-of-control, pension benefits and stock compensation related expense for Messrs. Horner and Leverton. In addition, the Company has been accruing change-of-control costs related to employee retention agreements. These agreements require that certain key employees remain actively employed by the Company for one year following a change-of-control. With respect to these employee retention agreements, the Company has accrued \$0.3 million and \$1.1 million for the three and nine months ended September 30, 2007. The Company expects that these retention payments will be paid in the fourth quarter of 2007.

On February 14, 2007, the Company announced a restructuring program that involves a reduction of 350 positions across the Company to be completed by year-end. In addition, on May 30, 2007, the Company announced plans to indefinitely curtail the operation of its No. 4 paper machine in Port Alberni, and to overhaul the corporate structure which involves the elimination of a further 130 positions, the relocation of the corporate offices, and the centralization of some mill and corporate administrative functions. On August 27, 2007, the Company, focused on improving its competitive position, announced further downsizing of 85 employees, to be accomplished largely through early retirement.

The implementation of the total corporate overhaul program, including downsizing of 565 positions, centralization of functions and relocation of the Vancouver office to Richmond is expected to be completed by December 31, 2007.

**Notes to the consolidated financial statements** (continued)  
(Unaudited and in millions of dollars, except where otherwise noted)

For the three and nine months ended September 30, 2007, the Company's restructuring and change-of-control expenses and related provisions included in current liabilities at September 30, 2007 are provided in the following table:

	<b>Three months ended September 30, 07</b>	<i>Nine months ended September 30, 07</i>
Restructuring and change-of-control provision, beginning of period	<b>\$ 26.3</b>	\$ –
Expense in period	<b>24.4</b>	62.7
Cash payments	<b>(5.2)</b>	(16.2)
Other non-cash items	<b>0.7</b>	(0.3)
Restructuring and change-of-control provision, end of period	<b>46.2</b>	46.2
Less: Non-current portion in employee future benefits and other long-term obligations	<b>(20.1)</b>	(20.1)
Restructuring and change-of-control provision in current liabilities	<b>\$ 26.1</b>	\$ 26.1

The Company will record any remaining liability in subsequent periods as the affected positions are identified and the necessary conditions are met in accordance with the Emerging Issues Committee Abstract No. 134, "Accounting for Severance and Termination Benefits".

#### **4 OTHER INCOME (EXPENSE), NET**

Other income (expense), net for the three and nine months ended September 30, 2007 includes \$7.4 million loss on disposal on the sale of the Company's previously permanently closed Port Alberni No. 3 paper machine and ancillary assets. Other income (expense), net for nine months ended September 30, 2007 also includes \$1.2 million of finance related expenses in respect of a proposed \$200 million private debt placement which the Company decided to withdraw due to adverse capital market conditions.

#### **5 FUTURE INCOME TAXES**

Income tax recovery for the nine months ended September 30, 2007 includes a release of future income taxes of \$1.4 million related to the reduction in future federal corporate income tax rates. Since the federal corporate income tax rate change was substantially enacted in the second quarter of 2007 as defined in the Emerging Issues Committee Abstract No. 111, "Determination of Substantially Enacted Tax Rates Under CICA 3465", the Company has recorded the impact of the half percentage point rate reduction in the second quarter of 2007.

*Notes to the consolidated financial statements (continued)*  
*(Unaudited and in millions of dollars, except where otherwise noted)*

## 6 SEGMENTED INFORMATION

The Company operates in three business segments:

Specialty Paper	• Manufacture and sale of groundwood specialty printing paper
Newsprint	• Manufacture and sale of newsprint
Pulp	• Manufacture and sale of long and short fibre pulp and containerboard

The segments are managed separately, and all manufacturing facilities are located in the province of British Columbia, Canada. Inter-segment sales consist of pulp transfers at cost.

## 7 PROPERTY, PLANT & EQUIPMENT AND MEASUREMENT UNCERTAINTY

As at September 30, 2007, the net book value of the indefinitely curtailed No. 4 paper machine in Port Alberni amounted to approximately \$65 million. The Company will monitor market conditions in the future and assess whether they improve sufficiently to allow this machine to be placed back into production. As a result, the Company has not recorded an impairment for the indefinite curtailment. To the extent that market conditions do not improve in a reasonable period of time and to the levels necessary to restart the machine, a write-down may have to be recorded in the future.

## 8 LONG-TERM DEBT

The Company's long-term debt, all of which matures beyond one year, is as follows (see note 2):

	<b>September 30, 2007</b>	<i>December 31, 2006</i>
<b>Recourse</b>		
Senior notes, 8.625% due June 2011 (US\$400.0 million)	<b>\$ 391.7</b>	\$ 468.7
Senior notes, 7.375% due March 2014 (US\$250.0 million)	<b>246.5</b>	291.3
	<b>638.2</b>	760.0
Revolving operating facility of up to \$350.0 million due July 2009 with interest based on Canadian Prime/BA rates or U.S. Base/LIBOR rates	<b>67.1</b>	–
	<b>705.3</b>	760.0
<b>Non-recourse</b>		
First mortgage bonds, 6.387% due July 2009	<b>74.5</b>	75.0
Subordinated promissory notes	<b>19.5</b>	19.5
Loan payable	<b>0.5</b>	–
	<b>94.5</b>	94.5
	<b>\$ 799.8</b>	\$ 854.5

**Notes to the consolidated financial statements** (continued)  
(Unaudited and in millions of dollars, except where otherwise noted)

Substantially all of the assets of the Company are pledged as security under the \$350.0 million revolving operating facility (the "Facility"). Its availability is determined by a borrowing base which is calculated based on accounts receivable and inventory balances, and includes covenants to maintain the funded debt/capitalization ratio below 60%, secured debt/capitalization ratio below 30% and shareholders' equity above \$779.3 million as at September 30, 2007. At September 30, 2007, the Company's shareholders' equity was \$984.2 million (December 31, 2006 – \$1,005.8 million). The borrowing base at September 30, 2007 was \$326.9 million and after drawings of \$67.1 million and outstanding letters of credit of \$20.7 million, \$239.1 million was available to the Company. An interest coverage covenant is applicable in certain circumstances if the Company incurs secured debt other than under the Facility. At September 30, 2007, no such debt has been incurred.

At September 30, 2007, the Company was in compliance with the covenants under both its Facility and senior notes. The Company's Fixed Charge Coverage Ratio ("FCC Ratio") under the senior note indentures, calculated on a 12-month trailing average, was 1.4:1 at September 30, 2007 (December 31, 2006 – 3.0:1). In the event that the FCC Ratio is below 2.0:1, the Company is limited in the amount of additional debt it may incur to "permitted debt" under the senior notes. Under the indenture for the 8.625% senior notes, "permitted debt" includes a) the Company's existing 8.625% notes and 7.375% notes, b) a credit facility basket in an amount equal to the greater of (i) \$725 million and (ii) the sum of 75% of the book value of the Company's accounts receivable, 50% of the book value of the Company's inventory and \$290 million, against which in either case utilization under the Company's \$350 million Facility is applied, c) purchase money debt and capital lease obligations in an amount equal to 5.0% of the Company's consolidated tangible assets, d) a \$40 million general basket, and e) a \$5 million basket for accommodation guarantees, trade or standby letters of credit, performance bonds, bankers' acceptances and surety bonds. The indenture for the 7.375% notes contains larger debt baskets, but while the 8.625% notes remain outstanding, the Company is bound by their more restrictive provisions. Also, the Company's restricted payments baskets under the 8.625% and 7.375% senior notes were negative \$194.1 million and negative \$169.1 million, respectively, as at September 30, 2007, as a result of accumulated losses in recent years (December 31, 2006 – negative \$72.5 million and negative \$47.5 million, respectively). Under the senior note covenants, the Company cannot pay dividends unless the balance in these baskets is positive.

Non-recourse debt is debt owed by the Company's subsidiary Powell River Energy Inc. ("PREI"). The Company has a 50% interest in PREI, and consolidates 100% of it as PREI is a variable interest entity in which the Company is the primary beneficiary.

## 9 EMPLOYEE FUTURE BENEFITS

The Company maintains pension benefit plans, which include defined benefit and defined contribution segments that are available to all salaried employees and to hourly employees not covered by union pension plans. The Company also provides other benefit plans consisting of provincial medical plan premiums, extended health care and dental benefits to eligible retired employees and their dependents. For the three and nine months ended September 30, 2007, the Company incurred a total post-retirement benefit cost of \$12.7 million and \$38.4 million, respectively (three and nine months ended September 30, 2006, \$14.8 million and \$43.4 million, respectively).

*Notes to the consolidated financial statements (continued)*  
(Unaudited and in millions of dollars, except where otherwise noted)

## 10 STOCK OPTIONS AND RESTRICTED SHARE UNITS

During the third quarter, the Company granted 1,804,624 stock options and 1,151,307 restricted share units ("RSUs") to its key executives. The stock options and RSUs are time and performance based and vest on December 31, 2009 subject to certain conditions having been met. The determination of the total number of stock options and RSUs earned is based on a 50% split between time in position, subject to a minimum return on capital employed benchmark, and the achievement of a relative return of capital employed performance valuation.

The fair value of the RSUs was based on the market value of the Company's shares on the day of the grant. The fair value of the options was estimated on the date of grant using the Black-Scholes Option pricing model with the following assumptions:

	<b>Three months ended September 30, 07</b>	<i>Nine months ended September 30, 07</i>
Risk-free interest rate	<b>4.5%</b>	4.5%
Annual dividends per share	<b>Nil</b>	Nil
Expected stock price volatility	<b>30.5%</b>	30.5%
Expected option life (in years)	<b>7.0</b>	6.7
Average fair value of options granted (in dollars)	<b>1.30</b>	1.25

Compensation expense related to the above noted options and RSUs has been based on management's best estimate of the outcome of the performance conditions in accordance with CICA Handbook Section 3870, "Stock-based Compensation and Other Stock-based Payments." For the three months and nine months ended September 30, 2007, the Company recorded \$0.7 million and \$2.3 million, respectively, as an expense for the stock option plans and restricted share units, \$0.3 million of which was related to the above mentioned grant in the third quarter.

## 11 FINANCIAL INSTRUMENTS

### *Derivative financial instruments*

The Company uses derivative financial instruments to reduce its exposure to foreign currency and price risk associated with its revenues, energy costs and long-term debt. The Company also uses interest rate swaps to manage its net exposure to interest rate changes. A summary of the Company's risk management objectives can be found on pages 71 and 72 of the Company's 2006 Annual Report.

Derivative financial instruments are accounted for in accordance with CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement", and, where applicable, Section 3865, "Hedges". Under these standards, all derivatives are recorded on the balance sheet at fair value (see note 2).

**Notes to the consolidated financial statements** (continued)  
(Unaudited and in millions of dollars, except where otherwise noted)

**(a) Revenue risk management instruments**

Foreign exchange exposure to foreign currency revenue and related receivables, primarily in U.S. currency, is managed through the use of foreign exchange forward contracts and options to sell foreign currencies.

The effective portion of changes in the fair value of derivatives that qualify and are designated as cash flow hedges are deferred and recorded as a component of AOCI until the underlying transaction is recorded in earnings. When the hedged item affects earnings, the gain or loss is reclassified from AOCI to "Sales". Any ineffective portion of a hedging derivative's change in fair value and the portion that is excluded from the assessment of hedge effectiveness is recognized immediately in "Sales". At September 30, 2007, instruments having a notional principal of US\$387 million are designated as hedging instruments. At period-end exchange rates, the net amount the Company would receive to settle the above contracts and options is \$49.8 million (December 31, 2006 – \$3.8 million).

Foreign currency options and forward contracts outstanding to sell U.S. dollars were as follows:

Term	Options						
	Purchased US\$ put			Sold US\$ call		Forward contracts	
	US\$millions	Average rate US\$/C\$	US\$millions	Average rate US\$/C\$	US\$millions	Average rate US\$/C\$	
As at September 30, 2007							
0 to 12 months	\$ 468	0.9224	\$ 108.8	0.8652	\$ 59.6	0.9427	
13 to 24 months	35	0.9409	–	–	–	–	
	<b>\$ 503</b>	<b>0.9236</b>	<b>\$ 108.8</b>	<b>0.8652</b>	<b>\$ 59.6</b>	<b>0.9427</b>	
As at December 31, 2006							
0 to 12 months	\$ 485	0.9031	\$ 205	0.8606	\$ 109	0.8727	
13 to 24 months	34	0.8982	32	0.8898	–	–	
	<b>\$ 519</b>	<b>0.9028</b>	<b>\$ 237</b>	<b>0.8644</b>	<b>\$ 109</b>	<b>0.8727</b>	

At September 30, 2007, commodity swap agreements to fix the sales price of northern bleached softwood kraft pulp within the next 12 months are outstanding for 21,000 metric tonnes. These contracts are not designated as hedging instruments for accounting purposes and are reported at their fair value, which was negative \$1.2 million (December 31, 2006 – negative \$0.3 million) at the end of the current quarter.

**(b) Cost risk management instruments**

Oil contracts and options outstanding were as follows:

**WTI NYMEX**

Term	Sold options		Purchased options		Fixed swap contracts	
	Barrels ("bbls" – 000's)	Average rate US\$/bbl	Barrels ("bbls" – 000's)	Average rate US\$/bbl	Barrels ("bbls" – 000's)	Average rate US\$/bbl
As at September 30, 2007	4	\$ 43.50	4	\$ 70.00	–	\$ –
As at December 31, 2006	–	\$ –	–	\$ –	30	\$ 31.55

Natural gas contracts and options outstanding were as follows:

#### **AECO Sumas**

<i>Term</i>	<i>Sold options</i>		<i>Purchased options</i>		<i>Fixed swap contracts</i>	
	<i>GJ (millions)</i>	<i>Average rate C\$/GJ</i>	<i>GJ (millions)</i>	<i>Average rate C\$/GJ</i>	<i>GJ (millions)</i>	<i>Average rate C\$/GJ</i>
As at September 30, 2007	1.1	\$ 6.33	1.1	\$ 9.09	–	\$ –
As at December 31, 2006	–	\$ –	0.4	\$ 7.91	1.0	\$ 8.33

The above instruments are not designated as hedging instruments for accounting purposes. At period-end contract rates, the net amount the Company would pay to settle these commodity contracts is \$0.7 million (December 31, 2006 – negative \$0.6 million).

#### **(c) Long-term debt risk management instruments**

The Company is party to forward foreign currency contracts or options to acquire U.S. dollars totalling US\$227 million (December 31, 2006 – US\$23 million) over a seven-year period at rates averaging US\$/C\$1.0730. These instruments are not designated as hedging instruments for accounting purposes, and are included in "Other long-term obligations" on the balance sheet at their fair value. Settlements and changes in fair value are recognized in "Foreign exchange gain (loss) on translation of long-term debt". At period-end exchange rates, the net amount the Company would pay to settle these contracts is \$9.8 million (December 31, 2006 – \$4.0 million).

#### **(d) Interest rate swaps**

The Company has entered into fixed-to-floating interest rate swaps on US\$80 million, under which it will receive a fixed rate of 7.375%, and pay a floating rate of U.S. six-month LIBOR plus 2.0%. The swaps mature March 1, 2014, although US\$10 million are cancellable at the counterparties' option between March 1, 2009 and March 1, 2014 for premiums which mirror the call premiums on the 7.375% senior notes. These instruments are designated as fair value hedging instruments. The effective portion of changes in the fair value of the derivatives are netted in "Long-term debt" and the ineffective portion is recognized in "Interest expense". At period-end swap rates, the net amount the Company would receive to settle these contracts is \$1.4 million (December 31, 2006 – \$1.2 million).

## **12 COMPARATIVE FIGURES**

Certain comparative figures presented in the interim consolidated financial statements have been reclassified to conform to the current period presentation.

### Investor relations contact

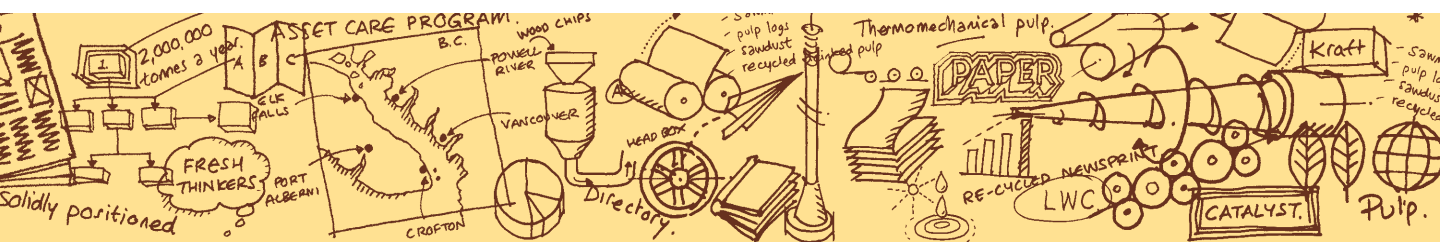
Lyn Brown  
Vice-President, Corporate Relations  
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### Transfer agent and registrar

CIBC Mellon Trust Company  
at its principal offices in  
Vancouver and Toronto.

### Share information

Common Shares (symbol: CTL)  
The Toronto Stock Exchange

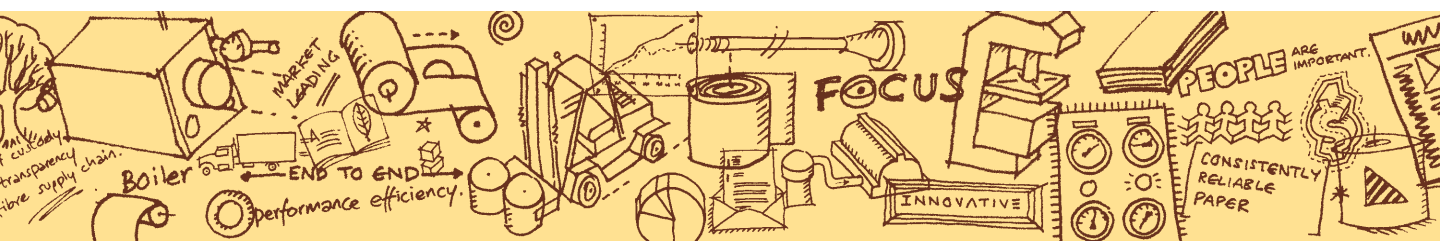


### Production Notes

Printed on 66.5 gsm Electrastar 80, containing 100% certified wood fibre and produced at Catalyst Paper's Powell River Division in accordance with PricewaterhouseCoopers' independent chain of custody certification standard.

Printed by Metropolitan Fine Printers Inc., Vancouver, British Columbia, using UV inks that comply with CONEG regulations for heavy metals, contain no alcohol, solvents, ammonia or formaldehyde; are completely recyclable and release no volatile organic compounds into the environment.





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