

DRIVING EFFICIENCY

CATALYST PAPER 2010 THIRD QUARTER REPORT
for the three months ended September 30, 2010

Q3

Catalyst



COMPANY PROFILE

Catalyst Paper manufactures diverse specialty mechanical printing papers, newsprint and pulp. Its customers include retailers, publishers and commercial printers in North America, Latin America, the Pacific Rim and Europe. With four mills, located in British Columbia and Arizona, Catalyst has a combined annual production capacity of 2.0 million tonnes. The company is headquartered in Richmond, British Columbia, Canada and its common shares trade on the Toronto Stock Exchange under the symbol CTL. Catalyst is listed on the Jantzi Social Index® and is ranked by Corporate Knights magazine as one of the 50 Best Corporate Citizens in Canada.

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PRESIDENT'S MESSAGE

We benefitted during the third quarter from stabilization in North American paper demand and generally improved market conditions. Sales volumes and prices were up and our results for this quarter were significantly improved over last quarter which bore the brunt of the Elk Falls and Paper Recycling facility closure costs.



TO OUR SHAREHOLDERS

With the North American jobless economic recovery continuing to temper print advertising and publishing conditions, the paper business is challenging. Recent pricing momentum is welcome though underlying weak demand for print advertising slowed full implementation of announced price increases in the quarter. The recent run-up in pulp prices also appears to have peaked, as Chinese demand continues to be the main driver of fluctuations in this market.

Better market conditions were not the only factor in our improved third quarter results but they opened the door to opportunities as we continued to focus on mill and machine efficiency and cost reduction. With the permanent closure of Elk Falls and Paper Recycling facilities – which were high cost operations – we expect annualized savings in the range of \$13 million in 2011. Reduced labour costs and property taxes helped keep average delivered cash costs down. Capital spending continued to be held in check.

Catalyst Paper posted net earnings for the quarter of \$6.0 million (\$0.02 per common share) on sales of \$322.3 million. This compares to sales of \$299.4 million in the second quarter and a loss of \$368.4 million (\$0.96 per common share) due largely to impairment, severances and other closure costs of \$302.0 million relating to the Elk Falls and Paper Recycling Divisions.

Before specific items, the net loss was \$9.6 million (\$0.03 per common share), in contrast to a net loss before specific items of \$43.9 million (\$0.11 per common share) in the prior quarter. Specific items in the third quarter included a foreign exchange gain of \$16.3 million on the translation of U.S. dollar denominated debt. EBITDA in the third quarter was \$34.2 million in contrast to EBITDA of negative \$0.4 million in the prior quarter, while EBITDA before specific items was \$34.5 million in contrast to \$10.5 million in the prior quarter.

In addition to stabilizing North American demand, strong export shipments and continued capacity closures helped to reduce inventory levels, increase operating

rates and improve markets for all of our paper products in the third quarter. Prices were up across all grades, and demand for both coated and uncoated papers improved over a year ago, although directory and newsprint demand remained weak. Demand for Northern Bleached Softwood Kraft pulp was down from Q2, and prices declined from an early-Q3 peak.

Previously announced price increases for newsprint, coated and uncoated grades were largely implemented in the quarter with the exception of some contracts, and additional increases were announced for September.

One newsprint machine at Crofton, representing 23 per cent of segment capacity, remained indefinitely curtailed.

At \$183.9 million, liquidity was down marginally from \$208.3 million a quarter earlier, and up from \$157.9 a year earlier. The quarter-over-quarter reduction was due mostly to the open market purchase of US\$9.5 million of our 8.625 per cent senior notes, due June 2011, for US\$8.9 million. Liquidity was also affected by property tax and severance payments in the third quarter.

We continue to pursue legal relief relating to tax assessments by the District of North Cowichan and the City of Campbell River (regional district portion), as well as to work outside the courts towards more sustainable fiscal relationships with all the BC municipalities in which we operate. We filed for leave to appeal to the Supreme Court of Canada in connection with the challenge of the District of North Cowichan's 2009 tax and were granted leave to appeal on October 28, 2010. The appeal to the Supreme Court of Canada is expected to be heard in mid to late 2011.

We expect further price momentum across our paper grades during the fourth quarter, while pulp prices are

likely to decline. Curtailment is expected to remain at the same level as in the third quarter, consisting of 35,300 tonnes of newsprint capacity at Crofton. Rising input costs and a strong Canadian dollar will continue to negatively impact results going forward.

This is the first full quarter since my appointment and I appreciate the full scope of challenges – including improving our balance sheet – that remain to be addressed. Even so, I am pleased with the progress we are beginning to make and confident that our momentum will continue.

The improvements we delivered in the third quarter reflect the merit of a company-wide focus on innovation

– from Pacificote, our new coated four product, to more aggressive leverage of our environmental performance through our Sage line of products, to extraordinary attention to product quality and efficiency in the manufacturing and supply chain units of our business. Innovation and teamwork will remain at the heart of our drive to put our company on stronger footing in the quarters ahead.



Kevin J. Clarke

President and Chief Executive Officer
November 2, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis ("MD&A") of Catalyst Paper Corporation (the "company", "we", "us", and "our") should be read in conjunction with our interim consolidated financial statements for the three month and nine month periods ended September 30, 2010 and September 30, 2009, and our audited annual consolidated financial statements for the year ended December 31, 2009 and the notes thereto, which have been prepared in accordance with generally accepted accounting principles ("GAAP") in the United States ("U.S."). Information on the impact of Canadian GAAP on our interim consolidated earnings and consolidated balance sheets is presented in note 20, "Reconciliation of United States and Canadian generally accepted accounting principles" of our interim consolidated financial statements for the three months and nine months ended September 30, 2010. Additional information about the company, including our most recent Annual Information Form is available on our website at www.catalystpaper.com, or the Canadian Securities Administrator's electronic filing website at www.sedar.com.

Throughout this discussion, references are made to certain measures that are not measures of performance under U.S. GAAP, including operating earnings, EBITDA, EBITDA before specific items, average delivered cash costs per tonne before specific items, net earnings (loss) attributable to the company before specific items, net earnings (loss) per share attributable to the company's common shareholders before specific items, and free cash flow. Management believes that these non-GAAP measures are useful in evaluating the performance of the company and its business segments. These non-GAAP measures are defined and reconciled to their nearest GAAP measure in Section 6, "Non-GAAP Measures".

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

In this MD&A, the term "tonne" and the symbol "MT" refer to a metric tonne and the term "ton" or the symbol "ST" refer to a short ton, a measure of weight equal to 0.9072 metric tonnes, and the symbol "Bdt" refers to bone dry tonnes. Use of these symbols is in accordance with industry practice.

The information in this report is as at November 2, 2010, which is the date of filing in conjunction with our press release announcing our results for the third quarter of 2010. Disclosure contained in this document is current to November 2, 2010, unless otherwise stated.

Cautionary Statement Regarding Forward-looking Statements

This MD&A contains forward-looking statements including those under the headings “Strategy Update”, “Liquidity and Capital Resources”, “Contingent Liabilities”, “Risks and Uncertainties” and “Outlook”. Forward-looking statements are statements that address or discuss activities, events or developments that we expect or anticipate may occur in the future, including statements relating to overall economic conditions, future cost savings, capital expenditures, demand for our products, product prices and advertising levels, production volumes, future cash flows and liquidity, currency rates, covenant compliance, severance obligations, strength of markets, availability of fibre, curtailment of operations, and the impact of labour disruptions affecting suppliers. These forward-looking statements can be identified by the use of statements that include words such as “believe”, “expect”, “anticipate”, “intend”, “plan”, “likely”, “predicts”, “estimates”, “forecasts”, and similar words or phrases or the negative of these statements. These forward-looking statements reflect our current views and are based on certain assumptions including assumptions as to future economic conditions and courses of action as well as other factors we believe 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 we 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 impact of general economic conditions in the United States, Canada and other countries in which we do business
- market conditions and demand for our products and the outlook for inventories, production and pricing
- declines in advertising and circulation
- expected cash flows, capital expenditures and completion of capital projects
- our ability and that of our agents to sell our products in export markets
- the implementation of trade restrictions and sanctions in jurisdictions we market our products;
- business strategies and measures to implement strategies
- our history of losses
- the cyclical nature of our business
- the effects of intense competition
- competitive strengths, goals, expansion and growth of our business and operations
- shifts in industry capacity
- fluctuations in foreign exchange or interest rates
- our ability to successfully obtain cost savings from our cost reduction initiatives
- labour unrest
- fluctuations in the availability and cost of raw materials, including fibre and energy
- implementation of environmental legislation requiring capital for operational changes
- the availability of qualified personnel or management
- the outcome of certain litigation or disputes
- conditions in the capital markets and our ability to obtain financing and refinance existing debt
- other factors beyond our control

Additional information concerning these and other factors can be found in Section 10 of this MD&A under the heading “Risks and Uncertainties”. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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

1 OVERVIEW AND HIGHLIGHTS

BUSINESS OVERVIEW

We are the largest producer of mechanical printing papers in western North America. We also produce NBSK pulp and market that pulp primarily in Asia. Our business is comprised of three business segments: specialty printing papers, newsprint, and pulp. Specialty printing papers include lightweight coated, uncoated mechanical, and directory paper. We are the only producer of lightweight coated paper and SC paper in western North America. We operate four paper mills, three of which are located in British Columbia in Crofton, Port Alberni and Powell River and one in Snowflake, Arizona which produces 100% recycled-content paper. Our Crofton mill includes a two-line kraft pulp operation.

During the quarter we permanently closed our Elk Falls mill in Campbell River, B.C., and our paper recycling facility in Coquitlam, B.C. The closure of our Elk Falls mill removed 153,000 tonnes of specialty printing papers capacity and 373,000 tonnes of newsprint capacity on an annualized basis. As a result, our combined annual production capacity decreased from 2,507,000 tonnes to 1,981,000 tonnes of pulp and paper product. More information about our business segments, product profile, and our geographic sales distribution is provided on pages 9 to 13 of our 2009 Annual Report. Our production capacity by mill and product line, reflecting the closure of our Elk Falls mill, is summarized in the following chart:

Capacity by Mill Location and Product Line ¹

Mill location	Number of paper machines	Specialty printing papers ¹			Newsprint ¹	Pulp	Total
		Uncoated mechanical	Lightweight coated	Directory	Newsprint	NBSK pulp	
Crofton, B.C. ²	3	-	-	183,000	234,000	403,000 ³	820,000
Port Alberni, B.C.	2	-	231,000	112,000	-	-	343,000
Powell River, B.C.	3	368,000	-	-	104,000	-	472,000
Snowflake, Arizona	2	65,000	-	-	281,000	-	346,000
Total capacity (tonnes)		433,000	231,000	295,000	619,000	403,000	1,981,000
% of total capacity		22%	12%	15%	31%	20%	100%

1 Capacities expressed in the above table can vary as we are able to switch production between products, particularly newsprint, directory and machine-finished uncoated grades.

2 We have indefinitely curtailed the No.1 paper machine at Crofton, removing the equivalent of 140,000 tonnes of newsprint production on an annualized basis. The capacity and number of machines noted in the above table have not been adjusted to reflect this indefinite curtailment.

3 Total pulp capacity at Crofton is 403,000 tonnes, of which 343,000 tonnes are designated as market pulp with the remainder being consumed internally.

THIRD QUARTER OVERVIEW

Third quarter results were a significant improvement over the prior quarter. Market conditions for our pulp and paper products improved in Q3 and results reflect the benefit of higher prices and sales volumes, as well as stronger operational performance in the current quarter.

Financial Performance

Catalyst recorded net earnings attributable to the company of \$6.0 million and a net loss attributable to the company before specific items of \$9.6 million in Q3. This compared to a net loss of \$368.4 million and \$43.9 million, respectively, in Q2. Significant specific items in Q3 included a foreign exchange gain on the translation of U.S. dollar denominated debt. Significant specific items in the prior quarter included impairment, severance and other closure cost charges and a foreign exchange loss on the translation of U.S. dollar denominated debt.

EBITDA and EBITDA before specific items were \$34.2 million and \$34.5 million in Q3 compared to negative \$0.4 million and positive \$10.5 million in Q2. Refer to section 6, *Non-GAAP Measures*, for additional information on specific items in the reported financial results.

SELECTED FINANCIAL INFORMATION

(In millions of Canadian dollars, except where otherwise stated)	YTD	2010 Q3	Q2	Q1	YTD	2009 ¹ Q3	Q2	Q1
Sales	\$ 895.0	\$ 322.3	\$ 299.4	\$ 273.3	\$ 928.5	\$ 266.9	\$ 300.7	\$ 360.9
Operating earnings (loss)	(367.7)	5.1	(323.9)	(48.9)	0.3	(10.0)	(21.5)	31.8
EBITDA ²	17.6	34.2	(0.4)	(16.2)	109.1	25.9	14.3	68.9
– before specific items ²	42.9	34.5	10.5	(2.1)	125.6	25.9	26.6	73.1
Net earnings (loss) attributable to the company	(406.5)	6.0	(368.4)	(44.1)	31.4	13.2	(1.9)	20.1
– before specific items ²	(91.1)	(9.6)	(43.9)	(37.6)	(37.0)	(19.8)	(25.6)	8.4
EBITDA margin ²	2.0%	10.6%	(0.1%)	(5.9%)	11.8%	9.7%	4.8%	19.1%
– before specific items ²	4.8%	10.7%	3.5%	(0.8%)	13.5%	9.7%	8.8%	20.3%
Net earnings (loss) per share attributable to the company's common shareholders (in dollars)								
– basic and diluted	\$ (1.06)	\$ 0.02	\$ (0.96)	\$ (0.12)	\$ 0.08	\$ 0.03	\$ (0.01)	\$ 0.06
– before specific items ²	(0.24)	(0.03)	(0.11)	(0.10)	(0.09)	(0.05)	(0.06)	0.02
(In thousands of tonnes)								
Sales	1,200.8	412.1	404.5	384.2	1,099.2	346.4	358.9	393.9
Production	1,195.9	417.7	403.0	375.2	1,071.0	348.5	330.9	391.6

1 Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

2 Refer to Section 6, *Non-GAAP Measures*.

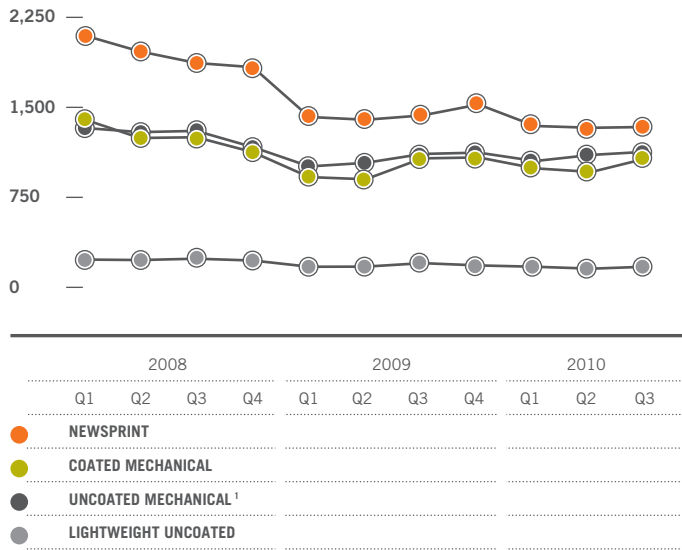
Market Overview

Overall, market conditions improved for all paper grades due to relatively low inventory levels and higher operating rates resulting from stabilizing North American demand, strong export shipments and capacity closures. North American demand for coated and uncoated mechanical grades continued to recover modestly compared to weak demand levels of a year ago. Demand for directory paper and newsprint remained weak for the quarter. Paper prices increased across all grades; however, overall business conditions continued to remain challenging in Q3.

North American Paper Demand

(In thousands of metric tonnes)

(Source: PPPC)



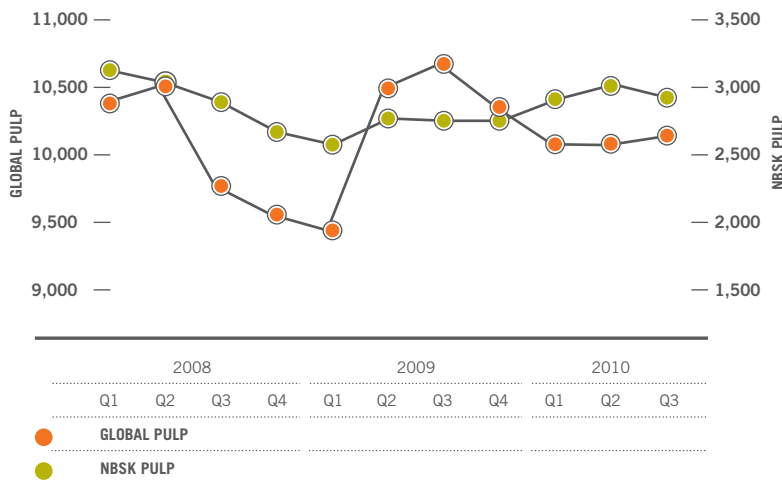
1 Uncoated mechanical is comprised of high-gloss and standard grades.

Global pulp shipments were down by 5.0% for the quarter compared to last year as pulp demand in China decreased during the quarter. NBSK pulp shipments increased year-over-year led by strong demand from Europe while quarter-over-quarter NBSK pulp shipments were down from a very strong Q2. NBSK pulp benchmark prices reached their peak early in the quarter before falling due to lower demand from China and increasing producer inventories.

Global and NBSK Pulp Shipments

(In thousands of metric tonnes)

(Source: PPPC)



Permanent Closure of the Elk Falls Mill and the Coquitlam Paper Recycling Facility

We completed the permanent closure of the Elk Falls mill and the Coquitlam paper recycling facility by the end of the third quarter following our July 6, 2010 announcement. For the nine months ended September 30, 2010, we recorded a \$302.9 million charge for impairment, severances, and other closure costs, of which \$302.0 million was recorded in Q2 and \$0.9 million in the current quarter. We expect that annualized fixed cost savings of approximately \$13.0 million will be realized in 2011, with further savings expected as the assets of the facilities are disposed of.

Property Tax Dispute

A total of \$19.2 million in municipal and provincial property taxes for 2010 was levied by the B.C. municipalities where we have mills. On July 2, 2010, we paid the full amount of property taxes for 2010 with the exception of property taxes levied by the District of North Cowichan. The amount of unpaid property taxes owing to North Cowichan for 2010, together with the 10% penalty for late payment, was \$4.4 million as of November 2, 2010. Our property tax expense and liability has been recorded based on the full amount of property taxes levied for 2010. All of our outstanding 2009 property taxes and associated penalties and interest have been paid in full.

We continue to press for a fair and sustainable level of municipal property taxes for major industry in the B.C. communities where we operate. Our court actions and discussions with governments are summarized on pages 15 and 16 of our 2009 Annual Report. Following the B.C. Court of Appeal's dismissal on April 22, 2010, of our appeal of the 2009 property taxes assessed by the District of North Cowichan, we filed for leave to appeal this decision to the Supreme Court of Canada. The Court granted us leave to appeal on October 28, 2010. The appeal to the Supreme Court of Canada is expected to be heard in mid to late 2011.

On June 7, 2010, we filed a petition with the Supreme Court of B.C. regarding the 2010 property taxes levied by the District of North Cowichan. No further steps have been taken by us or the District of North Cowichan in connection with the outstanding 2010 property taxes owing to North Cowichan pending the decision of the Supreme Court of Canada on our application for leave to appeal in connection with the 2009 North Cowichan property tax levy. On June 14, 2010, we filed a petition with the B.C. Supreme Court with respect to the Strathcona Regional District portion of the property taxes levied by the City of Campbell River for 2010 on the basis that an improper ratio was used in the calculation. The Court found in our favour on this point in our appeal of the 2009 property taxes in the previous year. The petition was heard on July 23, 2010 but, as of November 2, 2010, the Court has not issued its decision.

STRATEGY UPDATE

Our objective is to return to profitability and maximize cash flows by focusing on reducing manufacturing costs and optimizing our brands and customer base. Additional information related to our corporate strategy, including key performance drivers and indicators, can be found on pages 20 to 23 of our 2009 Annual Report.

2010 Key Priorities

The following is an update on our third quarter progress towards our 2010 key priorities:

Focus on cash flows and liquidity:

- Free cash flow was \$11.0 million, liquidity decreased by \$24.4 million largely due to the purchase of our US\$9.5 million 8.625% senior notes due June 2011 for US\$8.9 million, \$17.3 million payment for property taxes and \$7.3 million payment for severances
- Capital expenditures were \$2.4 million, primarily towards maintenance of business projects

Match production to customer orders and keep inventories at appropriate levels:

- Continued to curtail Crofton newsprint production in response to continued year-over-year declines in demand; curtailment represented approximately 23% of newsprint capacity and paper finished goods inventory continued to remain at low levels throughout Q3

Develop higher-value grades at the B.C. mills and produce 100% recycled high-bright and directory grades at the Snowflake mill:

- Continued to develop new grades at our Powell River, Port Alberni and Snowflake mills
- Introduced Electrabrite Book, our range of caliper-controlled papers for book publishers; also launched Electrabrite 100% FSC recycled from our Snowflake mill
- Launched our Pacificote coated four grade and our Sage line of environmentally-friendly papers
- Aggressively targeted new customers to support our grade improvement program; our sales force has made excellent progress in penetrating these marketplaces

Implement initiatives to reduce fixed costs:

- Continued to take legal actions in pursuit of municipal property tax reductions
- We reduced salary staffing levels by approximately 35 positions to continue to carry out business efficiently

Reduce labour costs and develop more flexible and efficient work practices:

- Continued to emphasize the need for a reset to the pattern agreement based on industry precedent

Improve the safety performance at all mills, with a target lost time incident ("LTI") rate of 1.0 and medical injury rate ("MIR") of 3.0:

- Continued to focus on workplace and work practice audits, although results were mixed: the LTI rate for Q3 remained at Q2 levels of 2.0, while the MIR for Q3 deteriorated from 3.4 in Q2 to 4.1 in Q3

CONSOLIDATED RESULTS OF OPERATIONS**Sales****Q3 2010 vs. Q2 2010**

Sales increased by 7.6% primarily due to higher prices and increased shipments across most grades.

Q3 2010 vs. Q3 2009

Sales increased by 20.8% due to higher pulp sales volumes and higher transaction prices for our pulp and paper products, with the exception of directory paper. There were no pulp sales in Q3 2009 as pulp operations were curtailed throughout Q3 of last year. These positive factors were partially offset by the negative impact of a stronger Canadian dollar in the current quarter.

2010 YTD vs. 2009 YTD

Sales decreased by 3.6% due to lower directory paper sales volumes, lower paper prices, and a stronger Canadian dollar in 2010, partially offset by higher pulp prices and shipments.

EBITDA and EBITDA before Specific Items

The following table provides variances between periods for EBITDA and EBITDA before specific items:

(In millions of dollars)	Q2 2010	Q3 2009	2009 YTD
EBITDA in comparative period¹	\$ (0.4)	\$ 25.9	\$ 109.1
Specific items: restructuring costs	10.9	–	16.5
EBITDA before specific items in comparative period¹	10.5	25.9	125.6
Paper prices	14.2	10.5	(69.8)
Pulp prices ²	2.2	–	57.1
Impact of Canadian dollar on sales, inclusive of hedging ³	0.3	(9.9)	(74.1)
Volume and mix	4.3	18.5	0.6
Furnish mix and costs	–	(6.5)	(2.4)
Lower of cost or market impact on inventory, net of inventory change	2.7	(0.6)	(5.2)
Other, net	0.3	(3.4)	11.1
EBITDA before specific items in the current period¹	34.5	34.5	42.9
Specific items: restructuring costs	(0.3)	(0.3)	(25.3)
EBITDA in the current period¹	\$ 34.2	\$ 34.2	\$ 17.6

1 Refer to Section 6, *Non-GAAP Measures*.

2 Pulp prices are not comparable from Q3 2009 to Q3 2010 as there was no pulp sales in Q3 2009.

3 Estimated total impact on EBITDA of average foreign exchange effective rate movement is \$0.2 million from Q2 2010 to Q3 2010, negative \$4.0 million from Q3 2009 to Q3 2010, and negative \$31.0 million from 2009 YTD to 2010 YTD.

Operating Earnings (Loss)

Q3 2010 vs. Q2 2010

Operating earnings improved by \$329.0 million due to higher EBITDA of \$34.6 million, asset-impairment and closure costs of \$0.9 million in Q3 compared to \$292.3 million in Q2 and lower depreciation and amortization of \$3.0 million in Q3.

Q3 2010 vs. Q3 2009

Operating earnings improved by \$15.1 million due to higher EBITDA of \$8.3 million and lower depreciation and amortization expense of \$7.7 million. This was partially offset by an asset impairment charge of \$0.9 million in the current quarter.

2010 YTD vs. 2009 YTD

Operating loss increased by \$368.0 million due to the asset-impairment and closure costs charge of \$293.2 million in the current period and lower EBITDA of \$91.5 million. This was partially offset by lower depreciation and amortization expense of \$16.7 million.

Net Earnings (Loss) Attributable to the Company

Q3 2010 vs. Q2 2010

Net earnings attributable to the company improved by \$374.4 million primarily due to higher after-tax operating earnings of \$329.0 million and an after-tax foreign exchange gain on the translation of long-term debt of \$16.3 million compared to an after-tax loss of \$21.3 million in Q2.

Q3 2010 vs. Q3 2009

Net earnings attributable to the company decreased \$7.2 million due to the lower after-tax foreign exchange gain on the translation of long-term debt of \$16.7 million and higher after-tax interest expense by \$7.4 million. This was offset primarily due to increased after-tax operating earnings of \$12.1 million and higher after-tax other income of \$6.8 million, most of which was comprised of a foreign exchange gain as a result of the favourable impact of the stronger Canadian dollar.

2010 YTD vs. 2009 YTD

Net loss attributable to the company deteriorated by \$437.9 million. This was largely due to the decline in after-tax operating earnings of \$354.0 million, primarily driven by the asset-impairment and closure cost charge of \$293.2 million. Other negative factors included lower after-tax gain on translation of U.S. dollar denominated debt of \$47.8 million, higher after-tax interest expense of \$12.1 million, and a \$0.5 million after-tax gain on cancellation of long-term debt compared to an after-tax gain of \$26.1 million in 2009.

2 SEGMENTED RESULTS

SPECIALTY PRINTING PAPERS

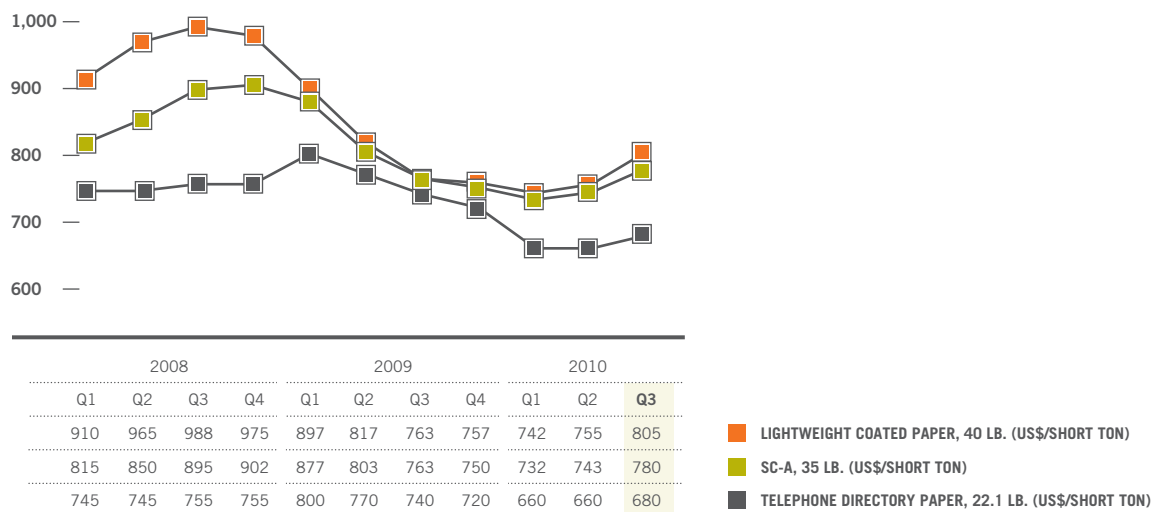
(In millions of Canadian dollars, except where otherwise stated)	Three months ended September 30			Nine months ended September 30		
	2010	2009 ¹	Change	2010	2009 ¹	Change
Sales	\$ 181.8	\$ 205.3	\$ (23.5)	\$ 511.0	\$ 629.6	\$ (118.6)
Operating earnings (loss)	(1.8)	11.9	(13.7)	(142.2)	42.5	(184.7)
Depreciation and amortization	20.8	24.4	(3.6)	61.1	70.4	(9.3)
EBITDA ²	19.5	36.3	(16.8)	22.7	112.9	(90.2)
– before specific items ²	19.6	35.8	(16.2)	30.9	124.2	(93.3)
EBITDA margin ²	10.7%	17.7%	(7.0%)	4.4%	17.9%	(13.5%)
– before specific items ²	10.8%	17.4%	(6.6%)	6.0%	19.7%	(13.7%)
(In thousands of tonnes)						
Sales	220.6	232.9	(12.3)	635.7	657.5	(21.8)
Production	226.6	237.8	(11.2)	647.9	663.1	(15.2)

¹ Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

² Refer to Section 6, *Non-GAAP Measures*.

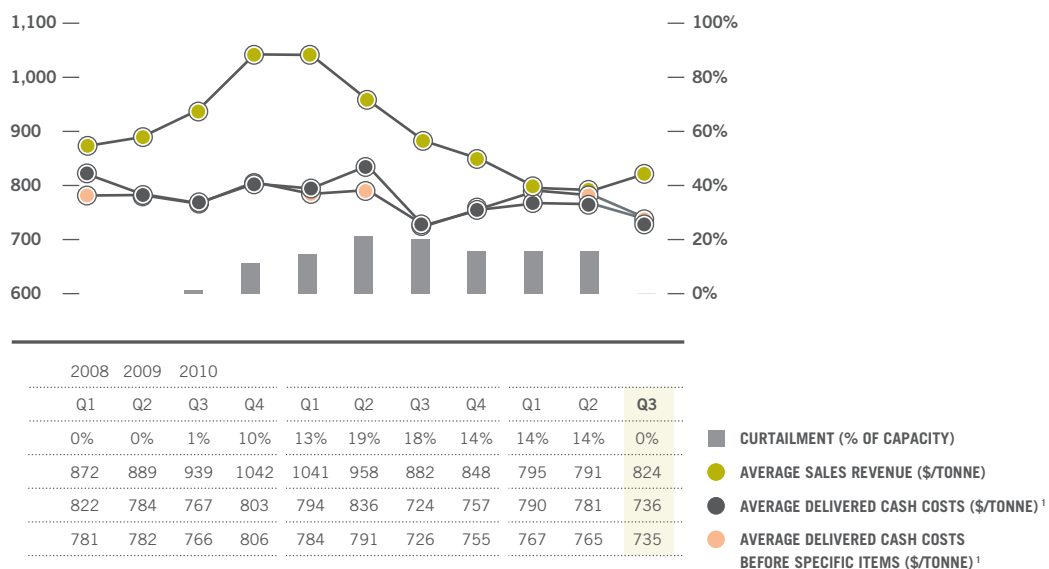
Specialty Printing Papers Benchmark Price Trends

Average delivered to U.S. benchmark transaction price (US\$)
(Source: RISI)



The following chart summarizes the operating performance of our specialty printing papers segment:

Specialty Printing Papers Trends



¹ Average delivered cash costs per tonne consist of cost of sales, excluding depreciation and amortization, and including the impact of SG&A and restructuring costs. Average delivered cash costs per tonne before specific items consist of cost of sales, excluding depreciation and amortization, and including the impact of SG&A, but excluding the impact of restructuring costs.

Segment Overview

North American demand for coated mechanical, high gloss and standard paper grades increased compared to the prior quarter and compared to the same quarter last year (refer to Section 1, *Overview and Highlights*, for North American paper demand graph). These factors, combined with recent industry capacity shuts and relatively low mill and printer inventory levels caused industry operating rates to remain strong across coated, high-gloss, and standard uncoated grades and benchmark prices for these grades increased in Q3. As a result, we were able to implement the remainder of our announced Q2 increases with the exception of some contract business. We also announced a US\$60 per short ton price increase for U.S. shipments of our Pacificote, Electracote-36 lb. and lower grades, Electrasoft, Electracal and Electraprime specialty paper grades and a US\$75 per short ton price increase for U.S. shipments of Electracote-38 lb. and higher grades, effective September 15, 2010. For Canadian-bound shipments, we announced price increases of \$66 per metric tonne and \$82.50 per metric tonne, respectively, for effect September 15, 2010.

Market conditions for directory paper improved in Q3 compared to the prior quarter, North American directory shipments increased, industry operating rates were strong and benchmark prices improved. However, compared to the same quarter last year, industry North American directory shipments were down 19.8%. The Q2 announced price increase of US\$70 per short ton on all spot sales, for effect July 1, 2010, was largely implemented in the quarter.

Operational Performance

Q3 2010 vs. Q3 2009

- Sales volume decreased by 12,300 tonnes, due to lower directory sales volume resulting from lower demand, partly offset by higher uncoated mechanical sales volumes.
- Average sales revenue decreased \$58 per tonne, reflecting lower average transaction prices for directory and the negative impact of the stronger Canadian dollar.
- Average delivered cash costs increased \$12 per tonne largely due to higher furnish cost, partly offset by lower labour and salaries, general administrative expenses and property taxes.

2010 YTD vs. 2009 YTD

- Sales volume decreased by 21,800 tonnes due to lower directory sales volumes, partly offset by higher uncoated and LWC sales volume.
- Average sales revenue decreased \$154 per tonne, reflecting lower average transaction prices and the negative impact of the stronger Canadian dollar.
- Average delivered cash costs decreased \$15 per tonne mostly due to lower labour and salaries, property taxes, and general administrative expenses. These were partly offset by higher furnish cost.

NEWSPRINT

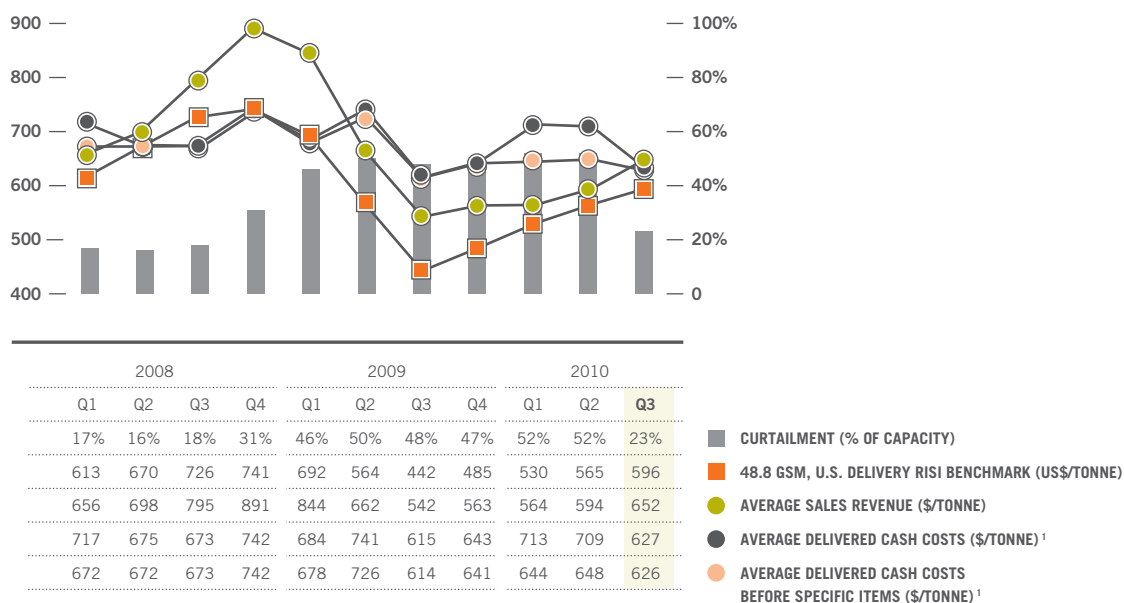
(In millions of Canadian dollars, except where otherwise stated)	Three months ended September 30			Nine months ended September 30		
	2010	2009 ¹	Change	2010	2009 ¹	Change
Sales	\$ 79.7	\$ 61.6	\$ 18.1	\$ 222.3	\$ 254.1	\$ (31.8)
Operating earnings (loss)	(1.1)	(18.3)	17.2	(239.2)	(32.1)	(207.1)
Depreciation and amortization	3.7	10.0	(6.3)	20.4	33.3	(12.9)
EBITDA ²	3.0	(8.3)	11.3	(29.4)	1.2	(30.6)
– before specific items ²	3.1	(8.1)	11.2	(13.3)	4.0	(17.3)
EBITDA margin ²	3.8%	(13.5%)	17.3%	(13.2%)	0.5%	(13.7%)
– before specific items ²	3.9%	(13.1%)	17.0%	(6.0%)	1.6%	(7.6%)
(In thousands of tonnes)						
Sales	122.3	113.5	8.8	368.5	369.9	(1.4)
Production	120.1	110.7	9.4	358.3	369.3	(11.0)

1 Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

2 Refer to Section 6, *Non-GAAP Measures*.

The following chart summarizes the operating performance of our newsprint segment:

Newsprint Trends



¹ Average delivered cash costs per tonne consist of cost of sales, excluding depreciation and amortization, and including the impact of SG&A and restructuring costs. Average delivered cash costs per tonne before specific items consist of cost of sales, excluding depreciation and amortization, and including the impact of SG&A, but excluding the impact of restructuring costs.

Segment Overview

Total North American demand for newsprint was down 6.7% in Q3, year-over-year, although the decline was not as pronounced as in prior quarters. Canadian demand increased year-over-year, partly offsetting the decline in U.S. demand and exports remained strong during the quarter. Exports for the quarter were up by 48.4% and increased by 60.9% through nine months. The combined effects of newsprint capacity closures and strong exports resulted in high industry operating rates, which along with declining mill and U.S. consumer inventories, led to an increase in Q3 newsprint benchmark prices. We implemented our previously announced price increases during Q3, and announced a US\$40 per tonne price increase for U.S. shipments effective September 1, 2010. This announced increase was partially implemented in September. The Crofton No.1 paper machine remained indefinitely curtailed throughout the quarter, resulting in 35,300 tonnes, or 23% of newsprint production capacity in Q3, based on our revised annualized production capacity.

Operational Performance

Q3 2010 vs. Q3 2009

- Sales volume increased by 8,800 tonnes due to higher swing production of newsprint versus directory.
- Average sales revenue increased \$110 per tonne due to higher average transaction prices, offset in part by the negative impact of the stronger Canadian dollar.
- Average delivered cash costs increased \$12 per tonne due to higher furnish cost, maintenance and supplies, and operating supplies, partly offset by lower labour and salaries, and property taxes.

2010 YTD vs. 2009 YTD

- Sales volume decreased marginally due to higher production curtailment related to Crofton No.1 paper machine and Elk Falls No.5 paper machine in 2010 offset by higher swing production of newsprint versus directory.
- Average sales revenue decreased \$84 per tonne due to lower transaction prices and the negative impact of the stronger Canadian dollar.
- Average delivered cash costs were at comparable levels for both periods. Before the impact of specific items, average delivered cash costs decreased \$36 per tonne largely due to lower labour and salaries. Refer to Section 6, *Non-GAAP Measures*, for details on average delivered cash costs before specific items.

PULP

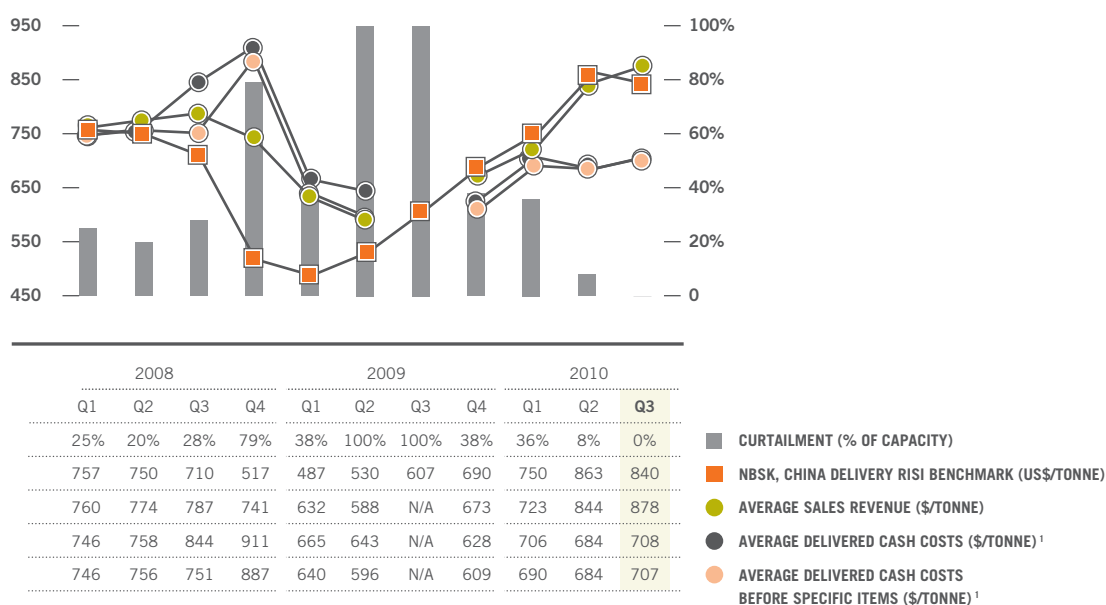
(In millions of Canadian dollars, except where otherwise stated)	Three months ended September 30			Nine months ended September 30		
	2010	2009 ¹	Change	2010	2009 ¹	Change
Sales	\$ 60.8	\$ —	\$ 60.8	\$ 161.7	\$ 44.8	\$ 116.9
Operating earnings (loss)	8.0	(3.6)	11.6	13.7	(10.1)	23.8
Depreciation and amortization	3.7	1.5	2.2	10.6	5.1	5.5
EBITDA ²	11.7	(2.1)	13.8	24.3	(5.0)	29.3
– before specific items ²	11.8	(1.8)	13.6	25.3	(2.6)	27.9
EBITDA margin ²	19.2%	–	19.2%	15.0%	(11.2%)	26.2%
– before specific items ²	19.4%	–	19.4%	15.6%	(5.8%)	21.4%
(In thousands of tonnes)						
Sales	69.2	–	69.2	196.6	71.8	124.8
Production	71.0	–	71.0	189.7	38.6	151.1

¹ Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

² Refer to Section 6, *Non-GAAP Measures*.

The following chart summarizes the operating performance of our pulp segment:

Pulp Trends



1 Average delivered cash costs per tonne consist of cost of sales, excluding depreciation and amortization, and including the impact of SG&A and restructuring costs. Average delivered cash costs per tonne before specific items consist of cost of sales, excluding depreciation and amortization, and including the impact of SG&A, but excluding the impact of restructuring costs.

Segment Overview

NBSK pulp markets softened in Q3 compared to Q2, as pulp capacity restarts and declining demand negatively affected benchmark pulp prices. Compared to the same quarter last year, benchmark pulp prices were significantly higher. With the restart of the second production line at Crofton in April 2010, pulp production was at full capacity this quarter, whereas production was fully curtailed in the same quarter last year. During the quarter, our maintenance costs increased over the prior quarter as we took 8.5 days of planned production shutdown related to the bi-annual major maintenance of the pulp assets.

Operational Performance

Q3 2010 vs. Q3 2009

- Sales volume increased by 69,200 tonnes in Q3 as pulp production was fully operational throughout the current quarter, compared to being curtailed throughout the same quarter of 2009.
- Average sales revenue per tonne in the current quarter is not comparable to the same quarter last year as there were no pulp sales in Q3 2009.
- Average delivered cash costs period-over-period are not comparable as there was no production or sales in Q3 2009.

2010 YTD vs. 2009 YTD

- Sales volume increased by 124,800 tonnes due to lower levels of curtailment in the 2010 period.
- Average sales revenue increased by \$198 per tonne due to higher average transaction prices and lower sales allowances, offset in part by the negative impact of the stronger Canadian dollar.
- Average delivered cash costs period-over-period increased \$9 per tonne but are not comparable as there was no production in Q2 and Q3 2009. The 2009 average delivered cash costs were also negatively impacted by the write-downs of raw materials inventory in 2009.

3 LIQUIDITY AND CAPITAL RESOURCES

SELECTED FINANCIAL INFORMATION

(In millions of Canadian dollars, except where otherwise stated)	Three months ended September 30			Nine months ended September 30		
	2010	2009	Change	2010	2009	Change
Cash flows provided (used) by operations before						
changes in non-cash working capital	\$ 11.3	\$ 4.9	\$ 6.4	\$ (43.7)	\$ 42.0	\$ (85.7)
Changes in non-cash working capital	(16.7)	1.4	(18.1)	(16.4)	54.6	(71.0)
Cash flows provided (used) by						
Operations	(5.4)	6.3	(11.7)	(60.1)	96.6	(156.7)
Investing activities	(3.4)	(0.5)	(2.9)	(1.8)	(1.3)	(0.5)
Financing activities	(9.7)	43.2	(52.9)	61.1	(9.7)	70.8
Capital spending	2.4	1.0	1.4	8.4	6.8	1.6
Depreciation and amortization	28.2	35.9	(7.7)	92.1	108.8	(16.7)
Impairment and other closure costs	0.9	–	0.9	293.2	–	293.2
Net debt to net capitalization at September 30	64%	45%	19%	64%	45%	19%

Refer to page 43 of our 2009 Annual Report for a discussion of the nature and sources of funding for our principal cash requirements.

OPERATING ACTIVITIES

Cash flows from operating activities in Q3 2010 decreased compared to the same quarter last year, primarily due to an increase in working capital requirements driven by lower curtailment, as well as our property tax and severance payments in the current quarter. This was partially offset by higher EBITDA in the current quarter.

INVESTING ACTIVITIES

Cash used by investing activities in the current quarter was slightly higher than the same quarter last year, primarily related to capital spending. Capital spending in both comparative periods related primarily to maintenance of business.

FINANCING ACTIVITIES

Cash used by financing activities in Q3 increased compared to the same quarter last year. This was primarily due to the purchase of US\$9.5 million of our 8.625% senior notes, due June 2011, for US\$8.9 million in the current quarter, the refinancing of Powell River Energy Inc.'s \$75 million debt with new debt of \$95 million in Q3 2009, and \$25.0 million drawings on the revolving loan in Q3 2009 compared to nil in Q3 2010.

CAPITAL RESOURCES

Availability on the ABL Facility and total liquidity is summarized in the following table:

(In millions of Canadian dollars)	2010				2009			
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	
Borrowing base	\$ 161.7	\$ 167.8	\$ 144.8	\$ 147.9	\$ 151.5	\$ 159.4	\$ 241.5	
Letters of credit	(25.1)	(25.3)	(24.0)	(24.1)	(24.2)	(24.8)	(25.8)	
Amount drawn	–	–	(25.0)	(14.5)	(25.0)	–	(38.8)	
Minimum excess availability	(35.0)	(35.0)	(35.0)	(35.0)	(35.0)	(35.0)	(35.0)	
Available to be drawn ¹	101.6	107.5	60.8	74.3	67.3	99.6	141.9	
Cash on hand	82.3	100.8	58.7	83.1	90.6	41.6	6.0	
Total liquidity	\$ 183.9	\$ 208.3	\$ 119.5	\$ 157.4	\$ 157.9	\$ 141.2	\$ 147.9	

1 The company's ABL Facility is subject to certain financial covenants as disclosed in our interim consolidated financial statements for the three and nine months ended September 30, 2010 in note 9, *Long-term debt*.

Our total liquidity increased by \$26.0 million from the same quarter last year primarily from the net proceeds of \$93.4 million received from the new bond issue in Q2 2010 partially offset by cash flows used by operations over the last four quarters. Liquidity decreased by \$24.4 million compared to the previous quarter largely due to the US\$9.5 million purchase of our 8.625% senior notes, and payments for property taxes and severances in the current quarter. For information related to the computation of our borrowing base and availability on the ABL Facility, refer to our interim consolidated financial statements for the three and nine months ended September 30, 2010, in note 9, *Long-term debt*.

At November 2, 2010, the company had 381,753,490 common shares issued and outstanding and 2,188,074 stock options for 2,188,074 common shares that, at November 2, 2010, were exercisable.

DEBT

During the quarter, we purchased US\$9.5 million of our 8.625% senior notes, due June 2011, in the open market for cash consideration of US\$8.9 million. A gain of \$0.6 million was recorded on the cancellation of this debt.

At September 30, 2010, the company was in compliance with the covenants under both our ABL Facility and senior notes. For details on covenant compliance, refer to our interim consolidated financial statements for the three and nine months ended September 30, 2010, note 9, *Long-term debt*.

FINANCIAL INSTRUMENTS

Financial instruments of the company consist primarily of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, long-term debt, and derivatives. Derivatives are used to reduce exposure to currency and price risk associated with revenues, energy costs and debt. For a description of the nature and extent of risk to the company from our financial instruments, as well as our respective accounting treatment of financial instruments, refer to our consolidated financial statements for the year ended December 31, 2009, note 26, *Financial instruments*, and in Section 8, *Changes in accounting policies* of this MD&A. For the methods and assumptions we use to determine the fair value of financial instruments, refer to note 25, *Fair value measurement*, of those statements. Our methods and assumptions for determining the fair value of financial instruments have not changed materially since those used in the preparation of our consolidated financial statements for the year ended December 31, 2009.

At September 30, 2010, we had foreign currency options and forward contracts with a notional principal of US\$330 million with major financial institutions. At September 30, 2010 period-end exchange rates, these instruments were reported at their fair value of \$8.0 million. Effective April 1, 2010, we no longer designate our U.S. dollar revenue risk management instruments as cash flow hedges for accounting purposes. For cash flow hedges that were in place as at March 31, 2010, the effective portion of changes in the fair value accumulated as at March 31, 2010 have been deferred and recorded in *Accumulated other comprehensive income (loss)*. When the hedge item is recorded in earnings, the corresponding gain or loss on the hedge will be reclassified from *Accumulated other comprehensive income (loss)* to *Sales*.

The following table reconciles the average spot to the company's effective rate and provides the impact to EBITDA related to the cash flow hedges that were in place as at March 31, 2010 and were designated as hedging instruments at that time:

US\$/CDN\$ foreign exchange	YTD	2010			2009 ¹			
		Q3	Q2	Q1	YTD	Q3	Q2	Q1
Average spot rate	0.966	0.962	0.973	0.961	0.855	0.911	0.855	0.803
(Favourable)/unfavourable impact of hedging*	(0.021)	(0.014)	(0.024)	(0.023)	0.006	(0.005)	0.005	0.029
Average effective rate	0.945	0.948	0.949	0.938	0.861	0.906	0.860	0.832
* Impact of effective portion of hedging (in millions of dollars)	\$ 13.9	\$ 3.8	\$ 5.2	\$ 4.9	\$ (9.6)	\$ 1.3	\$ (1.2)	\$ (9.7)

¹ Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

4 CONTINGENT LIABILITIES

The company's contingent liabilities at December 31, 2009 are described on pages 49 and 50 of our 2009 Annual Report. For additional and updated information regarding the company's contingent liabilities, refer to our interim consolidated financial statements for the three and nine months ended September 30, 2010 note 19, *Contingent liabilities*. There were no significant changes in Q3 2010.

5 SUMMARY OF QUARTERLY RESULTS

The following table highlights selected financial information for the eight consecutive quarters ending September 30, 2010:

(In millions of dollars, except per share amounts)	Q3	2010				2009 ¹			2008 ¹
		Q2	Q1	Q4	Q3	Q2	Q1	Q4	
Sales	\$ 322.3	\$ 299.4	\$ 273.3	\$ 295.0	\$ 266.9	\$ 300.7	\$ 360.9	\$ 499.9	
EBITDA ²	34.2	(0.4)	(16.2)	14.1	25.9	14.3	68.9	73.1	
Net earnings (loss) attributable to the company	6.0	(368.4)	(44.1)	(35.8)	13.2	(1.9)	20.1	(48.5)	
Net earnings (loss) per share attributable to the company's common shareholders									
– basic and diluted	\$ 0.02	\$ (0.96)	\$ (0.12)	\$ (0.09)	\$ 0.03	\$ (0.01)	\$ 0.06	\$ (0.13)	

1 Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

2 Refer to Section 6, *Non-GAAP Measures*.

Refer to Section 1, *Overview and Highlights*, and the discussion on *Consolidated Results of Operations*, for details of Q3 results compared to Q2.

For summary financial information about Powell River Energy Inc., a variable interest entity for which we are the primary beneficiary, refer to note 4, *Variable interest entities*, of our interim consolidated financial statements for the three and nine months ended September 30, 2010.

6 NON-GAAP MEASURES

Management uses certain measures that are not defined by U.S. GAAP to evaluate the performance of the company, and as a result, the measures as employed by management may not be comparable to similarly titled measures reported by other entities. These non-GAAP measures should not be considered by an investor as an alternative to their nearest respective GAAP measure. The company's non-GAAP measures include operating earnings (loss), EBITDA (earnings before interest, taxes, depreciation and amortization, impairment and other closure costs, and before other non-operating income and expenses), EBITDA before specific items, EBITDA margin, EBITDA margin before specific items, average delivered cash costs per tonne before specific items, net earnings (loss) attributable to the company before specific items, net earnings (loss) per share attributable to the company's common shareholders before specific items, and free cash flow.

Specific items are items of an unusual or non-recurring nature, or items that are subject to material volatility based on factors outside of management's control. Specific items include: foreign exchange gain or loss on long-term debt, gain or loss on cancellation of long-term debt, asset-impairment and other closure costs, restructuring costs, and certain income tax adjustments.

EBITDA AND EBITDA BEFORE SPECIFIC ITEMS

EBITDA as defined equates to operating earnings (loss) plus depreciation and amortization and impairment and other closure costs. EBITDA margin and EBITDA margin before specific items are defined as EBITDA and EBITDA before specific items as a percentage of sales. These measures enable comparison of consolidated and segment operating results between periods without regard to debt service, income taxes, capital expenditure requirements, and specific items.

Reconciliation to Net Earnings (Loss) Attributable to the Company:

(In millions of Canadian dollars)	2010				2009 ¹			
	YTD	Q3	Q2	Q1	YTD	Q3	Q2	Q1
Net earnings (loss) attributable to the company	\$ (406.5)	\$ 6.0	\$ (368.4)	\$ (44.1)	\$ 31.4	\$ 13.2	\$ (1.9)	\$ 20.1
Net earnings (loss) attributable to non-controlling interest	(0.7)	(0.4)	0.3	(0.6)	(1.9)	(0.9)	(1.1)	0.1
Net earnings (loss)	(407.2)	5.6	(368.1)	(44.7)	29.5	12.3	(3.0)	20.2
Depreciation and amortization	92.1	28.2	31.2	32.7	108.8	35.9	35.8	37.1
Impairment	293.2	0.9	292.3	–	–	–	–	–
(Gain) loss on cancellation of long-term debt	(0.6)	(0.6)	–	–	(30.7)	–	–	(30.7)
Foreign exchange (gain) loss on long-term debt	(8.6)	(16.3)	21.3	(13.6)	(64.2)	(38.9)	(37.9)	12.6
Other (income) expense, net	5.6	(2.8)	4.9	3.5	24.8	5.7	12.0	7.1
Interest expense, net	53.8	19.0	18.0	16.8	52.7	16.5	16.3	19.9
Income tax expense (recovery)	(10.7)	0.2	–	(10.9)	(11.8)	(5.6)	(8.9)	2.7
EBITDA	17.6	34.2	(0.4)	(16.2)	109.1	25.9	14.3	68.9
Specific items:								
Restructuring costs								
Specialty printing papers	\$ 8.2	\$ 0.1	\$ 3.3	\$ 4.8	\$ 11.3	\$ (0.5)	\$ 9.8	\$ 2.0
Newsprint	16.1	0.1	7.5	8.5	2.8	0.2	1.9	0.7
Pulp	1.0	0.1	0.1	0.8	2.4	0.3	0.6	1.5
Total specific items	25.3	0.3	10.9	14.1	16.5	–	12.3	4.2
EBITDA before specific items	\$ 42.9	\$ 34.5	\$ 10.5	\$ (2.1)	\$ 125.6	\$ 25.9	\$ 26.6	\$ 73.1

¹ Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

NET EARNINGS (LOSS) ATTRIBUTABLE TO THE COMPANY BEFORE SPECIFIC ITEMS

Specific items are defined above, and the exclusion of such items from net earnings (loss) attributable to the company facilitates the comparison of financial results between periods.

Reconciliation to Net Earnings (Loss) Attributable to the Company:

(In millions of Canadian dollars and after-taxes, except where otherwise stated)	2010				2009 ¹			
	YTD	Q3	Q2	Q1	YTD	Q3	Q2	Q1
Net earnings (loss) attributable to the company	\$ (406.5)	\$ 6.0	\$ (368.4)	\$ (44.1)	\$ 31.4	\$ 13.2	\$ (1.9)	\$ 20.1
Specific items:								
(Gain) loss on cancellation of long-term debt	(0.5)	(0.5)	—	—	(26.1)	—	—	(26.1)
Foreign exchange loss (gain) on long-term debt	(6.7)	(16.3)	21.3	(11.7)	(54.5)	(33.0)	(32.2)	10.7
Impairment and loss on disposal	293.2	0.9	292.3	—	—	—	—	—
Restructuring costs	21.3	0.3	10.9	10.1	11.5	—	8.5	3.0
Notes exchange costs	5.9	—	—	5.9	—	—	—	—
Income tax adjustments	2.2	—	—	2.2	0.7	—	—	0.7
Net earnings (loss) attributable to the company before specific items	\$ (91.1)	\$ (9.6)	\$ (43.9)	\$ (37.6)	\$ (37.0)	\$ (19.8)	\$ (25.6)	\$ 8.4
Net earnings (loss) per share attributable to the company's common shareholders in dollars:								
As reported	\$ (1.06)	\$ 0.02	\$ (0.96)	\$ (0.12)	\$ 0.08	\$ 0.03	\$ (0.01)	\$ 0.06
Before specific items	(0.24)	(0.03)	(0.11)	(0.10)	(0.09)	(0.05)	(0.06)	0.02

¹ Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

FREE CASH FLOW

Free cash flow excludes working capital and certain other sources and uses of cash, which are disclosed in the consolidated statements of cash flows. This measure allows us to assess our ability to generate funds to repay debt and assists in cash flow forecasting.

Reconciliation to Cash Provided by Operating Activities Less Cash Used by Investing Activities:

(In millions of Canadian dollars)	2010				2009 ¹			
	YTD	Q3	Q2	Q1	YTD	Q3	Q2	Q1
Cash provided (used) by operating activities	\$ (60.1)	\$ (5.4)	\$ (24.9)	\$ (29.8)	\$ 96.6	\$ 6.3	\$ 68.2	\$ 22.1
Cash provided (used) by investing activities	(1.8)	(3.4)	(1.8)	3.4	(1.3)	(0.5)	0.9	(1.7)
Proceeds from the sale of property, plant and equipment and other assets	(7.2)	(0.2)	(0.2)	(6.8)	(3.6)	(0.4)	(0.5)	(2.7)
Other investing activities	0.6	1.2	(0.8)	0.2	(1.9)	(0.1)	(2.6)	0.8
Non-cash working capital changes except change in taxes and interest	22.4	21.8	10.1	(9.5)	(53.8)	0.7	(74.3)	19.8
Other	(1.4)	(3.0)	(4.3)	5.9	18.8	3.3	10.1	5.4
Free cash flow	\$ (47.5)	\$ 11.0	\$ (21.9)	\$ (36.6)	\$ 54.8	\$ 9.3	\$ 1.8	\$ 43.7

1 Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

Management's Calculation of Free Cash Flow:

(In millions of Canadian dollars)	2010				2009 ¹			
	YTD	Q3	Q2	Q1	YTD	Q3	Q2	Q1
EBITDA	\$ 17.6	\$ 34.2	\$ (0.4)	\$ (16.2)	\$ 109.1	\$ 25.9	\$ 14.3	\$ 68.9
Interest expense, excluding amortization	(54.2)	(19.2)	(18.5)	(16.5)	(50.6)	(15.9)	(15.5)	(19.2)
Capital expenditures	(8.4)	(2.4)	(2.8)	(3.2)	(6.8)	(1.0)	(2.2)	(3.6)
Income taxes received (paid)	(0.2)	(0.4)	0.1	0.1	(0.4)	0.3	(0.3)	(0.4)
Employee future benefits, expense over (under) cash contributions ²	(2.3)	(1.2)	(0.3)	(0.8)	3.5	—	5.5	(2.0)
Free cash flow	\$ (47.5)	\$ 11.0	\$ (21.9)	\$ (36.6)	\$ 54.8	\$ 9.3	\$ 1.8	\$ 43.7

1 Refer to Section 8, *Changes in Accounting Policies* for a discussion of the change in our policy with respect to classification of gains and losses on certain of our derivative financial instruments and translation of foreign currency-denominated working capital balances effective January 1, 2010. Prior period comparative information has been restated.

2 Free cash flow is adjusted to reflect the cash impact of employee future benefits rather than the accounting expense which is included in EBITDA.

7 CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements requires companies to establish accounting policies and to make estimates that affect both the amount and timing of recording of assets, liabilities, revenues and expenses. Some of these estimates require judgments about matters that are inherently uncertain and actual results could differ from estimates.

On an ongoing basis, we review our estimates based upon currently available information. 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 57 to 61 of the company's 2009 Annual Report. There were no significant changes in Q3 2010.

8 CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2010, we changed our policy on the classification of foreign exchange gains and losses on the ineffective portion of our derivative financial instruments, on the portion that is excluded from the assessment of hedge effectiveness, and on translation of monetary assets and liabilities denominated in foreign currencies. The respective foreign exchange gains and losses previously recognized in *Sales* are now recognized in *Other income (expense), net*. We continue to classify the effective portion of gains or losses on our currently designated U.S. dollar revenue risk management instruments in *Sales*, the same income statement line item as the hedged item is classified in.

In addition, we changed our policy on the classification of changes in the fair value of all derivative commodity swap agreements not designated as hedges for accounting purposes that were previously recognized in *Sales* and *Cost of sales, excluding depreciation and amortization*. The changes in the fair value related to these instruments are now recognized in *Other income (expense), net*.

During 2010, we adopted the following new pronouncements issued by the Financial Accounting Standards Board ("FASB"):

- In June 2009, the FASB amended the Consolidation Topic of the Accounting Standards Codification, as it relates to the consolidation of variable interest entities. The amendments change how an entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, the entity's purpose and design and the company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. The amendments to this topic are effective January 1, 2010. The amendments had no impact on our consolidated financial statements or disclosures.
- In February 2010, the FASB amended its guidance on subsequent events contained in the Accounting Standards Codification. The amendments eliminate the requirement to disclose the date through which an entity has evaluated subsequent events. We adopted the amended guidance in our consolidated financial statement disclosures for our interim financial statements for periods beginning on or after January 1, 2010.

9 IMPACT OF ACCOUNTING PRONOUNCEMENTS AFFECTING FUTURE PERIODS

There were no new pronouncements issued by the FASB that may impact our consolidated financial statements for future periods.

10 RISKS AND UNCERTAINTIES

The company faces risks and uncertainties which 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 B.C.

In order to address these risks and effectively manage them, we have developed a process for managing risk and the interrelationships risks have with our strategic plan. We provide regular updates to the Audit Committee, work with corporate and operational management to identify, measure, and prioritize the critical risks facing the company, and manage 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 description of our risks and uncertainties can be found on pages 63 to 74 of our 2009 Annual Report. Our update as of November 2, 2010 can be found below:

The company's debt at December 31, 2009 is summarized in note 14, *Long-term debt* of our consolidated financial statements for the year ended December 31, 2009. Subsequent to year-end, on March 10, 2010, we completed a bond exchange and issued new recourse notes on May 19, 2010 as disclosed in note 9, *Long-term debt*, of our interim consolidated financial statements for the three and nine months ended September 30, 2010, resulting in total debt of \$835.6 million at September 30, 2010 compared to \$775.6 million at December 31, 2009. A number of our risks and uncertainties at December 31, 2009 referenced our total debt or our individual debt instruments as of that date, and these risks and uncertainties also apply to the total debt and the individual debt instruments outstanding at September 30, 2010. These risks and uncertainties include those under the following headings: *The Company's substantial debt may impair our financial and operating flexibility; We are exposed to the risks of exchange rate fluctuations; and A change of legal control of the Company could be materially adverse to the Company.*

Appointment of President and Chief Executive Officer effective June 21, 2010

Kevin Clarke was appointed President and Chief Executive Officer on June 21, 2010 following the resignation of Richard Garneau on May 31, 2010. Accordingly, the risks and uncertainties associated with the leadership transitions, and identified under the heading *The Company's current President and Chief Executive Officer has resigned from such positions effective May 31, 2010* in the *Risks and Uncertainties* section of our 2009 Annual Report, are no longer applicable.

The company has withheld payment of a portion of the assessed property taxes

Following the B.C. Court of Appeal dismissal of our North Cowichan petition in May 2010, we abandoned our other three appeals and paid all of our outstanding 2009 property taxes and applicable penalties and interest to the four municipalities. Accordingly the risks and uncertainties associated with the non-payment of the 2009 property taxes to these four municipalities identified under this heading in the *Risks and Uncertainties* section of our 2009 Annual Report are no longer applicable.

We owe \$4.4 million, including the 10% penalty for late payment, for unpaid 2010 property taxes in dispute related to North Cowichan as at November 2, 2010. There are risks and uncertainties associated with the partial payment of our 2010 property taxes. These risks and uncertainties are the same as those identified under this heading in the *Risks and Uncertainties* section of our 2009 Annual Report with respect to the non-payment of 2009 property taxes.

The company is subject to significant environmental regulation

In May 2010, the U.S. Environmental Protection Agency set thresholds for greenhouse gas ("GHG") permits under the Clean Air Act. This may affect the Snowflake mill within 3-5 years when facilities discharging more than 100,000 tons per year of greenhouse gases will be subject to permit requirements. On the basis that the Snowflake mill continues to operate at full production capacity, we expect that the mill's greenhouse gas emissions will be above this threshold. At this time, it is too early to tell what impact this may have on the company until the U.S. Environmental Protection Agency and the Snowflake mill begin discussions on the permit process.

The Province of B.C. is expected to issue further details of their previously announced cap and trade program for GHGs in Q4 2010 with regulations expected in Q1 2011. Under a worst case scenario, the increased costs to the company could be approximately \$2 million per year beginning in 2012 and increasing to \$9 million per year in 2020.

The B.C. Government's GHG reporting regulation that became effective on January 1, 2010 includes requirements for calculating and reporting GHG emissions from facilities that release 10,000 tonnes or more of GHGs per year plus third-party verification at facilities that release 25,000 tonnes or more. This regulation will affect the company's three paper mills in B.C.

The finalization of Canadian federal and provincial climate change regulation may depend on regulatory initiatives undertaken in the U.S. The U.S. is unlikely to impose national limits on GHGs before 2013 due to weak political support. When limits are developed, it is expected they will focus on the electricity generation sector. The U.S. Environmental Protection Agency's ("EPA") climate change regulatory initiatives may also be delayed by up to 2 years from the current 2011 imposition date. It is, therefore, too early to determine the overall impact these initiatives will have on the company or when they may come into effect.

In Q3 2010, the Snowflake mill completed its installation of a continuous monitor on its power boiler stack to monitor and report on carbon dioxide emissions in order to comply with the EPA Mandatory Reporting of GHGs Rule that came into effect on December 29, 2009. The EPA has announced plans to promulgate the Industrial Boiler MACT rule in December 2010. Assuming this occurs, the Snowflake mill will be required to reduce their power boiler emissions within 3 years at an estimated capital cost of \$8 million.

Effective July 1, 2010, the carbon tax rates under the B.C. government's carbon tax applicable to the company's purchases of fossil fuels increased by 33% and will increase again July 1, 2011. The impact to the company depends on our ability to decrease our use of fossil fuel, and on our mix of fossil fuel purchases.

In September 2010, the B.C. government announced a public referendum on the Harmonized Sales Tax ("HST") which was implemented on July 1, 2010. The referendum will be held in September 2011 and should it result in the abolition of the HST and a return to the previous provincial sales tax regime, the additional annualized cost to our business would be in the range of \$9 million to \$15 million.

11 SENSITIVITY ANALYSIS

Our earnings are sensitive to fluctuations in product prices, foreign exchange, energy and fibre costs as described on page 74 of our 2009 Annual Report and summarized in the following table:

(In millions of Canadian dollars, except per-share amounts)	EBITDA ¹	Net earnings ²	Earnings per share
Product prices³			
A US\$10 per tonne change in the sales price of:			
Specialty printing papers	\$ 9	\$ 6	\$ 0.02
Newsprint	5	4	0.01
Pulp	3	2	0.01
Foreign exchange⁴			
A US\$0.01 change in the U.S. dollar relative to the Canadian dollar	6	4	0.01
Energy cost sensitivity⁵			
A 5% change in the price of:			
Natural gas and oil – direct purchases	1	1	0.00
Electricity – direct purchases	6	4	0.01
Coal	1	1	0.00
Fibre sensitivity⁵			
A US\$5 per unit change in the price of:			
Wood chips (Bdt)	8	6	0.02
ONP (ST)	2	1	0.00

1 Refer to Section 6, *Non-GAAP measures*.

2 Based on an expected tax rate of 28.5%.

3 Based on annualized sales of Q3 2010 and foreign exchange rate of US\$0.96.

4 Based on Q3 2010 annualized net cash flows and a movement to US\$0.97 from US\$0.96 and excluding our hedging program and the impact of the translation of U.S. dollar-denominated debt.

5 Based on Q3 2010 annualized consumption levels and an exchange rate of US\$0.96.

12 OUTLOOK

Benchmark prices for all of our paper products are expected to continue to improve into Q4 and 2011, although for directory paper sales, the impact of price improvements will be realized in 2011 when new contract prices will be in effect. Despite upward pricing momentum, underlying demand for print advertising continues to be negatively affected by weak economic growth and other secular factors. The Crofton No.1 paper machine will continue to be indefinitely curtailed in Q4 representing approximately 35,300 tonnes of newsprint at our Crofton mill, or 23% of our newsprint capacity.

Global pulp shipments are expected to continue to soften in Q4 due in part to falling Chinese demand. Prices are expected to decline in Q4 as a result of lower demand and rising inventories.

Capital spending in 2010, net of Green Transformation Credits, is forecasted to be approximately \$17 million, compared to a previously announced forecast of \$20 million. Capital projects that should qualify for funding through the utilization of Green Transformation Credits have been submitted to the federal government for pre-approval, and while spending related to these projects may begin as early as Q4, we expect that the majority of the expenditures will be incurred in 2011.

Overall, while market conditions are improving for our paper products and we continue to realize fixed cost reductions and hold our capital expenditures in check, our net earnings, cash flows, and liquidity in future quarters will continue to be challenged by the strength of the Canadian dollar and rising input costs. Q4 2010 results will also be impacted by higher expected maintenance spending in the quarter compared to Q3 2010. We remain focused on reducing our cost base, conserving cash, and improving our product mix. Our progress to-date on our key priorities for 2010 is provided in Section 1, *Overview and Highlights*, and these remain the main focus moving forward.

13 DISCLOSURE CONTROLS AND INTERNAL CONTROL OVER FINANCIAL REPORTING

A summary of the company's regulatory requirements for the evaluation of internal controls and subsequent reporting of the results of that evaluation can be found on page 78 of the company's 2009 Annual Report. Based on an evaluation of the design and operation of the company's disclosure controls and procedures conducted under the supervision and with the participation of management, the company's chief executive officer and chief financial officer concluded that such disclosure controls and procedures (as defined in Canada under National Instrument 52-109 and in Rules 13a-15(e) and 15d-15(e) under the United States Securities Exchange Act of 1934), were effective as at December 31, 2009.

We did not make any significant changes in internal controls over financial reporting during the most recent three month and nine month periods ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting. Management has limited the scope of the design and maintenance of adequate disclosure controls and procedures and internal control over financial reporting to exclude controls, policies and procedures of Powell River Energy Inc., a variable interest entity in which we are the primary beneficiary.

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.

CONSOLIDATED BALANCE SHEETS

(in millions of Canadian dollars)	September 30, 2010 (unaudited)	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	\$ 82.3	\$ 83.1
Accounts receivable (note 17 (a))	116.3	101.5
Inventories (note 5)	146.6	178.3
Prepays and other (note 6)	29.9	25.2
	375.1	388.1
Property, plant and equipment (note 13)	1,315.4	1,664.7
Other assets (note 7)	39.3	38.0
	\$ 1,729.8	\$ 2,090.8
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 8)	\$ 172.7	\$ 173.3
Current portion of long-term debt (note 9)	27.9	1.0
	200.6	174.3
Long-term debt (note 9)	807.7	774.6
Employee future benefits	253.5	294.6
Other long-term obligations	19.7	13.4
Future income taxes (note 15)	26.6	22.8
Deferred credits	15.5	15.5
	1,323.6	1,295.2
Equity		
Shareholders' equity		
Common stock: no par value; unlimited shares authorized; issued and outstanding: 381,753,490 shares (December 31, 2009 – 381,753,490 shares)	1,035.0	1,035.0
Preferred stock: par value determined at time of issue; authorized 100,000,000 shares; issued and outstanding: nil shares	–	–
Additional paid-in capital	16.5	16.4
Deficit	(591.6)	(185.1)
Accumulated other comprehensive loss (note 11)	(34.3)	(52.7)
	425.6	813.6
Non-controlling interest (deficit) (note 4)	(19.4)	(18.0)
	406.2	795.6
	\$ 1,729.8	\$ 2,090.8

Contingent liabilities (note 19)

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

On behalf of the Board:



Kevin J. Clarke
Director



Thomas S. Chambers
Director

CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)

(Unaudited and in millions of Canadian dollars, except where otherwise stated)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Sales	\$ 322.3	\$ 266.9	\$ 895.0	\$ 928.5
Operating expenses				
Cost of sales, excluding depreciation and amortization	277.1	230.0	820.6	769.5
Depreciation and amortization	28.2	35.9	92.1	108.8
Selling, general and administrative	10.7	11.0	31.5	33.4
Restructuring (notes 12 and 13)	0.3	—	25.3	16.5
Impairment and other closure costs (note 13)	0.9	—	293.2	—
	317.2	276.9	1,262.7	928.2
Operating earnings (loss)	5.1	(10.0)	(367.7)	0.3
Interest expense, net	(19.0)	(16.5)	(53.8)	(52.7)
Foreign exchange gain on long-term debt	16.3	38.9	8.6	64.2
Other income (expense), net (note 14)	3.4	(5.7)	(5.0)	5.9
Earnings (loss) before income taxes	5.8	6.7	(417.9)	17.7
Income tax expense (recovery) (note 15)	0.2	(5.6)	(10.7)	(11.8)
Net earnings (loss)	5.6	12.3	(407.2)	29.5
Net loss attributable to non-controlling interest	0.4	0.9	0.7	1.9
Net earnings (loss) attributable to the Company	\$ 6.0	\$ 13.2	\$ (406.5)	\$ 31.4
Basic and diluted net earnings (loss) per share attributable to the Company's common shareholders (in dollars)	\$ 0.02	\$ 0.03	\$ (1.06)	\$ 0.08
Weighted average number of Company common shares outstanding (in millions)	381.8	381.8	381.8	381.8

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited and in millions of Canadian dollars)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Net earnings (loss)	\$ 5.6	\$ 12.3	\$ (407.2)	\$ 29.5
Other comprehensive income (loss), net of taxes:				
Employee future benefits liability adjustment	—	—	23.3	—
Reclassification of amortization of employee future benefits	0.5	1.3	1.5	2.6
Unrealized net gain on cash flow revenue hedges	—	7.6	4.2	12.7
Reclassification of net (gain) loss on cash flow revenue hedges	(2.8)	(0.8)	(10.0)	6.9
Foreign currency translation adjustments, net of related hedging activities	(0.7)	(3.0)	(0.7)	(4.9)
Unrealized gain (loss) on interest rate hedges	0.1	(0.1)	0.2	(1.2)
Other comprehensive income (loss)	(2.9)	5.0	18.5	16.1
Total comprehensive income (loss)	2.7	17.3	(388.7)	45.6
Comprehensive loss attributable to non-controlling interest:				
Net loss	0.4	0.9	0.7	1.9
Other comprehensive income, net of taxes	—	—	(0.1)	—
Comprehensive loss attributable to non-controlling interest	0.4	0.9	0.6	1.9
Comprehensive income (loss) attributable to the Company	\$ 3.1	\$ 18.2	\$ (388.1)	\$ 47.5

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

CONSOLIDATED STATEMENTS OF EQUITY

(in millions of Canadian dollars)	Equity attributable to the Company						
	Common stock		Additional paid-in capital	Retained earnings (deficit)	Accumulated other comprehensive income (loss)	Non- controlling interest (deficit)	Total
	Number of shares	\$					
Balance as at December 31, 2008	381,753,490	\$ 1,035.0	\$ 14.6	\$ (180.7)	\$ (46.4)	\$ (15.9)	\$ 806.6
Stock option compensation expense	—	—	1.8	—	—	—	1.8
Net earnings (loss)	—	—	—	(4.4)	—	(1.2)	(5.6)
Distributions to non-controlling interest	—	—	—	—	—	(0.3)	(0.3)
Other comprehensive loss, net of tax	—	—	—	—	(6.3)	(0.6)	(6.9)
Balance as at December 31, 2009	381,753,490	\$ 1,035.0	\$ 16.4	\$ (185.1)	\$ (52.7)	\$ (18.0)	\$ 795.6
Stock option compensation expense	—	—	0.1	—	—	—	0.1
Net earnings (loss)	—	—	—	(406.5)	—	(0.7)	(407.2)
Distributions to non-controlling interest	—	—	—	—	—	(0.8)	(0.8)
Other comprehensive income, net of tax	—	—	—	—	18.4	0.1	18.5
Balance as at September 30, 2010 (unaudited)	381,753,490	\$ 1,035.0	\$ 16.5	\$ (591.6)	\$ (34.3)	\$ (19.4)	\$ 406.2

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in millions of Canadian dollars)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Cash flows provided (used) by:				
Operations				
Net earnings (loss)	\$ 5.6	\$ 12.3	\$ (407.2)	\$ 29.5
Items not requiring (providing) cash				
Depreciation and amortization	28.2	35.9	92.1	108.8
Impairment and other closure costs (note 13)	0.9	—	293.2	—
Future income taxes	—	(5.1)	(10.9)	(10.7)
Foreign exchange gain on long-term debt	(16.3)	(38.9)	(8.6)	(64.2)
Gain on cancellation of long-term debt (note 9)	(0.6)	—	(0.6)	(30.7)
Employee future benefits, expense over (under) cash contributions	(1.2)	—	(2.3)	3.5
Decrease in other long-term obligations	(1.0)	(1.4)	(3.1)	(0.2)
Loss (gain) on disposal of property, plant and equipment	(0.5)	1.4	(6.5)	4.1
Other	(3.8)	0.7	10.2	1.9
Changes in non-cash working capital				
Accounts receivable	(1.9)	22.4	(14.8)	107.0
Inventories	0.6	(3.4)	12.6	35.0
Prepays and other	(7.1)	(10.4)	(4.6)	3.8
Accounts payable and accrued liabilities	(8.3)	(7.2)	(9.6)	(91.2)
Cash flows provided (used) by operations	(5.4)	6.3	(60.1)	96.6
Investing				
Additions to property, plant and equipment	(2.4)	(1.0)	(8.4)	(6.8)
Proceeds from sale of property, plant and equipment	0.2	0.4	7.2	3.6
Decrease (increase) in other assets	(1.2)	0.1	(0.6)	1.9
Cash flows used by investing activities	(3.4)	(0.5)	(1.8)	(1.3)
Financing				
Increase (decrease) in revolving loan and loan payable	—	25.0	(14.5)	(35.1)
Repayment of long-term debt	—	(75.7)	—	(75.7)
Proceeds from long-term debt	—	95.0	—	95.0
Proceeds on issuance of Class B senior secured notes (note 9)	—	—	98.4	—
Deferred financing costs	(0.2)	(0.8)	(4.5)	(0.9)
Note exchange costs	—	—	(8.3)	—
Proceeds on termination of debt foreign currency contracts	—	(0.1)	—	34.7
Settlement on purchase of debt securities	(9.2)	—	(9.2)	(26.9)
Decrease in other long-term debt	(0.3)	(0.2)	(0.8)	(0.8)
Cash flows provided (used) by financing activities	(9.7)	43.2	61.1	(9.7)
Cash and cash equivalents, increase (decrease) in the period	(18.5)	49.0	(0.8)	85.6
Cash and cash equivalents, beginning of period	100.8	41.6	83.1	5.0
Cash and cash equivalents, end of period	\$ 82.3	\$ 90.6	\$ 82.3	\$ 90.6
Supplemental disclosures:				
Income taxes paid (received)	\$ 0.4	\$ (0.3)	\$ 0.2	\$ 0.4
Net interest paid	14.2	15.9	49.4	50.6
Non-cash exchange of 8.625% senior notes	—	—	(327.1)	—
Non-cash issuance of 11.0% senior notes	—	—	287.2	—
Non-cash difference in carrying value of senior notes on modification	—	—	39.9	—

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

CONSOLIDATED BUSINESS SEGMENTS

(Unaudited and in millions of Canadian dollars)

Three months ended September 30, 2010	Specialty printing papers	Newsprint	Pulp	Total
Sales	\$ 181.8	\$ 79.7	\$ 60.8 ¹	\$ 322.3
Depreciation and amortization	20.8	3.7	3.7	28.2
Restructuring (note 12)	0.1	0.1	0.1	0.3
Impairment and other closure costs (note 13)	0.5	0.4	–	0.9
Operating earnings (loss)	(1.8)	(1.1)	8.0	5.1
Additions to property, plant and equipment	1.7	0.7	–	2.4

Three months ended September 30, 2009

Sales	\$ 205.3	\$ 61.6	\$ – ¹	\$ 266.9
Depreciation and amortization	24.4	10.0	1.5	35.9
Operating earnings (loss)	11.9	(18.3)	(3.6)	(10.0)
Additions to property, plant and equipment	0.5	0.6	(0.1)	1.0

Nine months ended September 30, 2010

Sales	\$ 511.0	\$ 222.3	\$ 161.7 ¹	\$ 895.0
Depreciation and amortization	61.1	20.4	10.6	92.1
Restructuring (note 12)	8.2	16.1	1.0	25.3
Impairment and other closure costs (note 13)	103.8	189.4	–	293.2
Operating earnings (loss)	(142.2)	(239.2)	13.7	(367.7)
Additions to property, plant and equipment	6.9	1.3	0.2	8.4

Nine months ended September 30, 2009

Sales	\$ 629.6	\$ 254.1	\$ 44.8 ¹	\$ 928.5
Depreciation and amortization	70.4	33.3	5.1	108.8
Restructuring (note 12)	11.3	2.8	2.4	16.5
Operating earnings (loss)	42.5	(32.1)	(10.1)	0.3
Additions to property, plant and equipment	3.8	2.9	0.1	6.8

¹ Pulp sales are stated net of inter-segment pulp sales of \$7.4 million for the three months ended September 30, 2010 (three months ended September 30, 2009 – \$0.2 million) and \$14.5 million for the nine months ended September 30, 2010 (nine months ended September 30, 2009 – \$13.3 million).

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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 the Company's joint venture, Powell River Energy Inc. ("PREI"), a variable interest entity ("VIE"). All inter-company transactions and amounts have been eliminated on consolidation.

Effective for the year ended December 31, 2009, the Company adopted U.S. generally accepted accounting principles ("U.S. GAAP") for presentation of its consolidated financial statements for Canadian and United States reporting requirements. Historically, the Company has presented its annual and interim consolidated financial statements in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") with reconciliation in its annual consolidated financial statements to U.S. GAAP for material recognition and measurement differences. As a result of this transition to U.S. GAAP, the Company has presented its 2009 annual audited consolidated financial statements in accordance with U.S. GAAP, including a reconciliation to Canadian GAAP for material recognition and measurement differences in note 33, *Reconciliation of United States and Canadian Generally Accepted Accounting Principles* and restated its interim consolidated financial statements for 2009.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. GAAP, on a basis consistent with those followed in the December 31, 2009 audited annual consolidated financial statements, except as disclosed in note 3 below. These unaudited interim consolidated financial statements do not include all information and note disclosures required by U.S. GAAP for annual financial statements, and therefore should be read in conjunction with the December 31, 2009 audited consolidated financial statements and the notes thereto. In the opinion of the Company, the unaudited interim consolidated financial statements contained herein contain all the information and note disclosures necessary to fairly present the results of the interim periods included. The results for the periods included herein may not be indicative of the results for the entire year.

2. SEGMENTED INFORMATION

The Company operates in three business segments:

Specialty printing papers	• Manufacture and sale of mechanical specialty printing papers
Newsprint	• Manufacture and sale of newsprint
Pulp	• Manufacture and sale of long-fibre Northern Bleached Softwood Kraft pulp

The segments are managed separately. The Company owns and operates four manufacturing facilities, three of which are located in the province of British Columbia, Canada and one is located in Arizona, U.S.A. Two other facilities, including a paper recycling facility, were permanently shutdown during the three months ended September 30, 2010 (note 13). Inter-segment sales consist of pulp transfers at cost up to December 31, 2009, and at market prices thereafter. The Company has not restated its comparative numbers for this change in policy as the change is not material to the comparative numbers. However, this change could be material in future periods if pulp market prices increase or average costs decrease.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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3. SIGNIFICANT ACCOUNTING POLICIES

Effective January 1, 2010, the Company changed its policy on the classification of foreign exchange gains and losses on the ineffective portion of its U.S. dollar revenue risk management instruments, on the portion that is excluded from the assessment of hedge effectiveness, and on translation of working capital balances denominated in foreign currencies. The respective foreign exchange gains and losses previously recognized in *Sales* are now recognized in *Other income (expense), net*. In addition, the Company also changed its policy on the classification of changes in the fair value of all commodity swap agreements not designated as hedges for accounting purposes that were previously recognized in *Sales* and *Cost of sales, excluding depreciation and amortization*. The changes in the fair value related to these instruments are now recognized in *Other income (expense), net*. The new policies adopted are considered preferable as they increase the transparency of the economic hedging activity. These changes were applied retrospectively.

For the three and nine months ended September 30, 2009, the above changes resulted in an increase of \$3.5 million and \$21.1 million, respectively, to *Sales* and \$0.5 million and \$2.1 million, respectively, to *Cost of sales, excluding depreciation and amortization*, with an offsetting decrease of \$3.0 million and \$19.0 million, respectively, to *Other income (expense), net*.

Effective April 1, 2010, the Company no longer designates its U.S. dollar revenue risk management instruments as cash flow hedges for accounting purposes. The effective portion of gains or losses accumulated as at March 31, 2010 on its previously designated U.S. dollar revenue risk management instruments are continuing to be recorded in the same income statement line items as the hedged item in *Sales*.

Recently Implemented Accounting Changes

In June 2009, the Financial Accounting Standards Board ("FASB") further amended the Consolidation Topic of the Accounting Standards Codification, as it relates to the consolidation of VIE's. The amendments change how an entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. Qualified special-purpose entities are no longer exempt from consolidation requirements. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. The amendments to this Topic become effective on January 1, 2010. The Company has assessed the impact of these amendments and has determined that these amendments have no impact on the Company's consolidated financial statements or disclosures as the Company continues to be the primary beneficiary in PREI.

In February 2010, the FASB amended its guidance on subsequent events contained in the Accounting Standards Codification. The amendments eliminate the requirement to disclose the date through which an entity has evaluated subsequent events. The Company adopted the amended guidance in its consolidated financial statement disclosures for its interim financial statements for periods beginning on or after January 1, 2010.

Changes in Future Accounting Standards

There were no new pronouncements issued by the FASB that may impact the Company's consolidated financial statements for future periods.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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4. VARIABLE INTEREST ENTITIES

The Company has a 50.0% interest in PREI and consolidates 100% of it as PREI is a VIE in which the Company is the primary beneficiary. PREI consists of an integrated hydroelectric power generating, transmission and distribution system which includes two hydroelectric stations in B.C. with installed capacity of 82 Megawatts. The Company purchases 100% of the power generated by PREI.

The Company has limited access to PREI's assets, which generally take the form of interest on loans, management fees and earnings distributions based on the Company's interest in PREI. In addition, creditors of PREI have recourse limited to the assets in PREI. Condensed financial information with respect to PREI is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Condensed statements of earnings (loss)				
Sales – affiliate ¹	\$ 4.8	\$ 3.7	\$ 15.7	\$ 11.5
Cost of sales, excluding depreciation and amortization	1.7	1.6	4.4	4.6
Depreciation and amortization	1.8	0.8	5.5	2.4
	3.5	2.4	9.9	7.0
Operating earnings	1.3	1.3	5.8	4.5
Interest expense	(2.3)	(2.3)	(6.7)	(6.7)
Interest expense – affiliate ¹	(0.4)	(0.7)	(1.6)	(2.1)
Other expense, net	0.1	(0.6)	0.1	(1.6)
Income tax recovery	0.5	0.5	1.0	2.1
Net earnings (loss)	(0.8)	(1.8)	(1.4)	(3.8)
Other comprehensive income (loss)	0.1	–	0.2	–
Total comprehensive income (loss) ²	\$ (0.7)	\$ (1.8)	\$ (1.2)	\$ (3.8)

1 Balances with Catalyst Paper Corporation.

2 50% is included in the Company's non-controlling interest (deficit) balances.

	September 30, 2010	December 31, 2009
Condensed balance sheets		
Current assets		
Cash and cash equivalents	\$ 2.7	\$ 5.5
Other	2.4	2.0
Property, plant and equipment	109.0	112.8
	\$ 114.1	\$ 120.3
Current liabilities		
Accounts payable and accrued liabilities	\$ 2.1	\$ 5.5
Long-term debt (note 9)	113.8	112.9
Long-term debt – affiliate ¹	20.8	20.8
Future income taxes	16.2	17.1
Equity ²	(38.8)	(36.0)
	\$ 114.1	\$ 120.3

1 Balances with Catalyst Paper Corporation.

2 50% is included in the Company's non-controlling interest (deficit) balances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The Company has identified one other potential VIE, but has not been able to obtain the financial information necessary to evaluate whether the entity is a VIE, or if the entity is a VIE, whether the Company is the primary beneficiary. The Company has entered into a building lease agreement with this potential VIE whereby the Company has agreed to continue making the prescribed lease payments directly to the financial institution holding the mortgage on the building in the event the lessor is no longer able to meet its contractual obligations. As at September 30, 2010, the principal amount of the mortgage was \$6.8 million (December 31, 2009 – \$7.9 million). This agreement does not increase the Company's liability beyond the obligation under the building lease.

5. INVENTORIES

The components of inventories were as follows:

	September 30, 2010	December 31, 2009
Finished goods		
Specialty printing papers	\$ 27.5	\$ 19.7
Newsprint	6.5	11.5
Pulp	2.3	6.4
Total finished goods	36.3	37.6
Work-in-progress	0.8	0.5
Raw materials – wood chips, pulp logs and other	29.6	36.4
Operating and maintenance supplies and spare parts (note 13)	79.9	103.8
	\$ 146.6	\$ 178.3

At September 30, 2010, the Company had applied write-downs of \$0.5 million to finished goods inventory (December 31, 2009 – \$1.7 million) and \$0.4 million to raw materials inventory (December 31, 2009 – \$3.6 million).

6. PREPAIDS AND OTHER

The components of prepaids and other were as follows:

	September 30, 2010	December 31, 2009
Property taxes, insurance and licenses	\$ 6.5	\$ 1.9
Derivative financial instruments	6.6	15.9
Future income tax assets	13.4	4.8
Other	3.4	2.6
	\$ 29.9	\$ 25.2

7. OTHER ASSETS

The components of other assets were as follows:

	September 30, 2010	December 31, 2009
Deferred financing costs	\$ 14.2	\$ 10.7
Deferred charges and other	10.0	9.6
Derivative financial instruments	1.4	3.1
Accrued benefit asset – pension plan	0.2	0.2
Future income tax assets	13.5	14.4
	\$ 39.3	\$ 38.0

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

The components of accounts payable and accrued liabilities were as follows:

	September 30, 2010	December 31, 2009
Trade payables	\$ 88.1	\$ 83.2
Accrued payroll and related liabilities	26.1	34.7
Accrued interest	16.7	10.8
Accrued benefit obligation – pension plan	12.2	6.7
Accrued benefit obligation – other employee future benefit plans	7.3	7.3
Restructuring (note 12)	5.3	5.2
Property taxes, and related penalties and interest	4.4	15.1
Operating lease obligation at paper recycling operation	3.0	–
Payables related to capital projects	1.2	2.3
Other	8.4	8.0
	\$ 172.7	\$ 173.3

9. LONG-TERM DEBT

	September 30, 2010	December 31, 2009
Recourse		
Senior notes, 8.625% due June 2011 (US\$26.0 million; December 31, 2009 – US\$354.2 million)	\$ 26.8	\$ 371.6
Senior notes, 7.375% due March 2014 (US\$250.0 million)	260.6	265.4
Senior secured notes, 11.0% due December 2016 (US\$280.4 million)	288.8	–
Modification – difference in carrying value of 8.625% and 11.0% senior secured notes (US\$38.3 million) on exchange	37.3	–
Class B senior secured notes, 11.0% due December 2016 (US\$110.0 million)	97.8	–
	711.3	637.0
Revolving asset based loan facility of up to \$330.0 million due August 2013	–	14.5
Capital lease obligations	10.5	11.2
	721.8	662.7
Non-recourse		
First mortgage bonds, 6.447% due July 2016	95.0	94.1
Subordinated promissory notes	18.8	18.8
	113.8	112.9
Total debt	835.6	775.6
Less: current portion	(27.9)	(1.0)
Total long-term debt	\$ 807.7	\$ 774.6

In September 2010, the Company purchased US\$9.5 million of its 8.625% senior unsecured notes, due June 2011 (“2011 Notes”), for cash consideration of US\$8.9 million. The Company recorded a gain of \$0.6 million on the cancellation of this debt (note 14). As of September 30, 2010, US\$26.0 million of 2011 Notes remain outstanding.

On May 19, 2010, the Company issued US\$110.0 million of Class B 11.0% senior secured notes due December 15, 2016 (“2016 Class B Notes”) at 86% of the principal amount, in a private placement generating net proceeds of \$93.4 million, after financing costs of approximately \$5 million. The new notes rank equally in right of payment with all of the Company’s existing and future senior secured notes. The notes are secured on a first-priority basis by all of the Company’s assets, with the exception of assets securing the Company’s existing \$330 million revolving asset based loan facility (the “ABL Facility”).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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On March 10, 2010, the Company issued US\$280.4 million of new 11.0% senior secured notes, due December 2016 ("2016 Class A Notes") in exchange for US\$318.7 million of its 2011 Notes. The Company issued US\$880 in principal amount of the 2016 Class A Notes for each US\$1,000 in principal amount of the 2011 Notes exchanged. As the cash flows of the principal and interest on a discounted basis over the life of the outstanding 2016 Class A Notes issued did not differ by more than 10% compared to the cash flows of the principal and interest on a discounted basis over the life of the 2011 Notes, the 2016 Class A Notes were accounted for as a modification of the 2011 Notes. Accordingly, the 2016 Class A Notes were recorded at the carrying value of the 2011 Notes exchanged of US\$318.7 million. The excess of US\$38.3 million of the carrying value of the 2011 Notes exchanged over the principal amount of the 2016 Class A Notes issued remained as part of the carrying value of the debt on the balance sheet and is being amortized as a reduction of interest expense, under the effective interest rate method, until the maturity of the 2016 Class A Notes. As the exchange was accounted for as a modification, the legal and other non-finance expenses of \$10.5 million associated with the exchange were expensed, of which \$8.3 million was expensed in the three months ended March 31, 2010.

The indentures governing the Company's senior notes contain customary restrictive covenants, including restrictions on incurring additional indebtedness, certain restricted payments including dividends and investments in other persons, the creation of liens, sale and leaseback transactions, certain amalgamations, mergers, consolidations and the use of proceeds arising from certain sales of assets and certain transactions with affiliates. Pursuant to a consent solicitation conducted concurrently with the exchange offer, substantially all of these restrictive covenants were eliminated with respect to the 2011 Notes that remain outstanding after the exchange, although certain covenants, including restrictions on the creation of liens and certain assets sales, remain applicable to the 2011 Notes. Collateral provided on the 2016 Class A Notes and 2016 Class B Notes (collectively "2016 Notes") consists of a first charge on substantially all of the assets of the Company, other than the ABL First Charge Collateral as described below (the "2016 Notes First Charge Collateral") and a second charge on the ABL First Charge Collateral. The indentures governing the 7.375% senior notes, due March 2014, ("2014 Notes") and the 2016 Notes limit the ability of the Company to incur debt, other than *permitted debt*, while the Company cannot meet a fixed charge coverage ratio of 2.0:1. The Company's fixed charge coverage ratio under these indentures, calculated on a 12-month trailing average, was 0.1:1 at September 30, 2010 (December 31, 2009 – 1.5:1).

Under the indentures for the 2014 Notes and 2016 Notes, *permitted debt* includes (a) the Company's existing 2011 and 2014 Notes; (b) a credit facility basket in an amount equal to the greater of (i) \$725 million and (ii) the sum of 85% of the book value of the Company's accounts receivable, 60% of the book value of the Company's inventory and \$375 million, against which the Company's utilization of the \$330 million ABL Facility applies to this basket under both the 2014 Note Indenture and 2016 Note Indentures, the 2016 Notes apply to this basket under the 2014 Note Indenture and the 2016 Class B Notes reduce this basket under the 2016 Note Indentures; (c) purchase money debt and capitalized lease obligations in an amount equal to 7.5% of the Company's consolidated tangible assets; (d) a \$100 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. In addition, the indenture governing the 2016 Notes includes a limitation of US\$411.7 million on the amount of 2016 Notes and additional debt that can be secured on a *pari passu* basis with the 2016 Notes, and restricts the ability of the Company to repurchase the 2014 Notes prior to their maturity unless, among other things, the Company has available liquidity under the ABL Facility and cash on hand of at least \$100 million. The Company cannot make any restricted payments, including paying any dividends, except to the extent the balance in its restricted payments baskets is positive. The restricted payments baskets under the 2014 Notes and 2016 Notes were negative \$293.4 million and negative \$77.4 million, respectively, as at September 30, 2010, as a result of accumulated losses in recent years (December 31, 2009 – negative \$176.0 million and \$nil, respectively).

The security for the ABL Facility and the related derivatives facilities consists of a first charge on the accounts receivable, inventory and cash of the Company and on the Snowflake mill property, plant and equipment and related rail operation (collectively, the "ABL First Charge Collateral") and a second charge on the 2016 Notes First Charge Collateral. Availability under the ABL Facility is determined by a borrowing base calculated primarily on eligible accounts receivable, eligible inventory and a value ascribed to the Snowflake mill fixed assets, less certain reserves. The borrowing base at September 30, 2010 includes a reserve of \$4.4 million for unpaid property taxes and associated penalties. A reserve may also be imposed for vacation pay obligations, which as at September 30, 2010 were \$18.8 million, if Excess Availability (as defined in the ABL Facility) is below \$75 million. Excess Availability was \$136.6 million at September 30, 2010. As at September 30, 2010, the borrowing base under the ABL Facility was \$161.7 million. After deducting outstanding drawings of \$nil, outstanding letters of credit of \$25.1 million, and the \$35.0 million minimum Excess Availability covenant, \$101.6 million was available to be drawn by the Company under the ABL Facility. The Company also had an additional \$82.3 million of cash on hand at such date.

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The financial covenants applicable under the ABL Credit Agreement must be maintained based upon the Company's financial results prepared under Canadian GAAP and include covenants to (a) maintain shareholders' equity above \$346.2 million as at September 30, 2010; (b) maintain Excess Availability of not less than \$35 million; and (c) not make capital expenditures in any fiscal year in an amount which exceeds 120% of the budgeted capital expenditures for such fiscal year. The minimum equity requirement is reduced by the amount of any non-cash write-downs of property, plant and equipment as a result of a permanent discontinuance of operations. At September 30, 2010, as calculated under the ABL Facility under Canadian GAAP, shareholders' equity was \$468.6 million (December 31, 2009 – \$881.4 million).

The ABL Facility also contains a number of covenants that, among other things, place restrictions on matters customarily restricted in such facilities, including indebtedness which encompasses guarantee obligations, liens, fundamental changes, investments, derivative transactions, sales of assets, changes in fiscal periods, environmental activity, negative pledges, subsidiary distributions and changes in lines of business as well as restrictions on voluntary prepayments of certain debt, including the senior notes, unless Excess Availability of at least \$65 million is maintained. The ABL Facility contains customary events of default, including failure to pay principal or interest when due, failure to comply with or observe key covenants, adverse judgements, seizures of property, material adverse change, auditors' going concern qualification, and change in control. Effective October 7, 2010, the covenant that no more than US\$17.7 million of the 2011 Notes can remain outstanding by March 15, 2011 was replaced by an additional reserve from the borrowing base for the amount of the 2011 Notes outstanding in excess of US\$17.7 million.

At September 30, 2010, the Company was in compliance with its covenants under the ABL Facility and under each of the indentures governing its outstanding senior notes.

Non-recourse debt is debt owed by the Company's subsidiary PREI. The Company has a 50% interest in PREI, and consolidates 100% of it as PREI is a VIE in which the Company is the primary beneficiary.

The Company's long-term debt is recorded at amortized cost. The following table contains information about management's best estimate of the fair value of the Company's debt:

	September 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Recourse	\$ 721.8	\$ 476.5	\$ 662.7	\$ 472.3
Non-recourse	113.8	121.3	112.9	113.8

The fair value of the Company's long-term recourse debt related to its senior notes is determined based on quoted market prices of identical debt instruments. The fair value of the Company's recourse debt related to the ABL Facility and non-recourse debt related to the first mortgage bonds is measured by discounting the respective cash flows at quoted market rates for similar debt having the same maturity. In measuring fair value, the Company incorporates credit valuation adjustments to appropriately reflect its own non-performance risk, where appropriate.

10. EMPLOYEE FUTURE BENEFITS

The Company maintains pension benefit plans for all salaried employees, which include defined benefit and defined contribution segments. Employees hired subsequent to January 1, 1994 enroll in the defined contribution segment. Effective January 1, 2010, employees in the defined benefit plan ceased to accrue benefits under the defined benefit segment of the plan and began to participate in the defined contribution segment of the plan. The Company also maintains pension benefits for former hourly employees that are not covered by union pension plans. Unionized employees of the Company are members of multi-employer industry-wide pension plans to which the Company contributes a predetermined amount per hour worked by an employee.

The Company provides other benefit plans consisting of provincial medical plan premiums, extended health care and dental benefits to employees. During the second quarter, the Company made the decision to permanently close Elk Falls mill and the reduction in the benefit obligation resulting from the plan curtailment amounting to \$9.7 million was recognized during the nine months ended September 30, 2010 with a corresponding increase to other comprehensive income.

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11. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table contains information about the accumulated other comprehensive income (loss) ("AOCI") of the Company, net of taxes:

	September 30, 2010	December 31, 2009
Unrecognized pension and other post-retirement benefits costs	\$ (36.1)	\$ (60.9)
Unrecognized gain on cash flow revenue hedges	1.9	7.7
Foreign currency translation adjustments, net of related hedging activities ¹	0.4	1.1
Unrecognized loss on interest rate hedges	(0.5)	(0.6)
	\$ (34.3)	\$ (52.7)

¹ The accumulated net adjustment is comprised of non-taxable translation gain of \$2.0 million (2009 – \$5.2 million gain), and a net revaluation of long-term debt designated as a net investment hedge of \$1.6 million loss (2009 – \$4.1 million loss), net of tax of \$0.2 million expense (2009 – \$0.3 million recovery).

12. RESTRUCTURING COSTS

The following table provides the activity in the restructuring liability:

	As at September 30, 2010	As at, December 31, 2009
Balance, beginning	\$ 6.8	\$ 16.3
Expensed in period	25.3	17.9
Disbursements	(26.6)	(22.3)
Other non-cash items	–	0.5
	5.5	12.4
Less: portion related to employee benefits	–	(5.6)
Balance, end of period	\$ 5.5	\$ 6.8
Classification:		
Accounts payable and accrued liabilities	\$ 5.3	\$ 5.2
Other long-term obligations	0.2	1.6
	\$ 5.5	\$ 6.8

The following table provides restructuring liability by year of initiatives:

	September 30, 2010	December 31, 2009
2007 Initiatives	\$ 0.4	\$ 0.6
2008 Initiatives	0.3	3.5
2009 Initiatives	1.2	2.7
2010 Initiatives	3.6	–
	\$ 5.5	\$ 6.8

During the nine months ended September 30, 2010, the Company recorded restructuring costs of \$25.3 million primarily related to severances payable to eligible employees at Elk Falls resulting from the permanent closure.

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13. IMPAIRMENT AND CLOSURE COSTS

As a result of the decision to permanently close the Company's Elk Falls paper mill and paper recycling operation during the nine months ended September 30, 2010, the Company recorded a \$302.9 million charge for related impairment, severances and other closure costs, of which \$0.9 million was recorded in the three months ended September 30, 2010. The Elk Falls mill had been indefinitely curtailed since February 2009 and the paper recycling facility was indefinitely idled in February 2010. The following table provides the components of the impairment, severances and other closure costs:

Property, plant and equipment	\$ 272.5
Operating and maintenance supplies and spare parts inventory (note 5)	20.3
	292.8
Less: impairment previously recorded on paper assets (prior to announcement of permanent closure)	(12.0)
Severances	9.7
Other closure costs – operating lease at paper recycling operation	12.4
Total	\$ 302.9

Classification in consolidated statement of earnings (loss):

Impairment and other closure costs	\$ 293.2
Restructuring (severances)	9.7
	\$ 302.9

Key assumptions used in calculating the liability associated with the closure of the paper recycling operation include estimates related to the timing and extent of sublease revenues and the estimates of other related closure costs. The closure costs of \$12.4 million relating to the operating lease at the paper recycling operation are comprised of total rental payments over the lease term to 2023 of \$43.5 million, including estimated property taxes and fixed operating costs, reduced by estimated sublease payments and discounted using a discount rate of 16.5%. If the timing and amount of actual net sublease payments, property taxes or fixed operating costs differ from these estimates, or the Company settles the outstanding liability through negotiations with the lessor, the resulting liability could vary from the recorded amount. This liability is being reviewed periodically and adjusted when necessary.

14. OTHER INCOME (EXPENSE), NET

The components of other income (expense), net, were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Fees related to bond exchange	\$ –	\$ –	\$ (8.3)	\$ –
Gain (loss) on derivative financial instruments	4.7	5.0	(7.4)	24.1
Foreign exchange gain (loss) on working capital balances	(2.1)	(8.0)	4.0	(43.1)
Gain on cancellation of long-term debt (note 9)	0.6	–	0.6	30.7
Gain (loss) on disposal of property, plant and equipment	0.5	(1.4)	6.5	(4.1)
Property tax penalty	(0.4)	(1.2)	(0.4)	(1.2)
Termination fee on closure of corrugating machine at Snowflake	–	–	–	(0.5)
Other	0.1	(0.1)	–	–
	\$ 3.4	\$ (5.7)	\$ (5.0)	\$ 5.9

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15. INCOME TAX EXPENSE (RECOVERY)

As at September 30, 2010, the Company has provided for a valuation allowance on its future tax assets of \$96.8 million. The effective tax rate for the three months ended September 30, 2010 was 4.1%. The effective rate is less than the statutory rate due to non recognition of the tax benefit of losses.

16. FAIR VALUE MEASUREMENTS

An established fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is available and significant to the fair value measurement. There are three levels of inputs that may be used to measure fair value:

Level 1

Quoted prices in active markets for identical assets or liabilities.

Level 2

Observable inputs other than quoted prices in active markets for identical assets and liabilities, such as quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3

Inputs that are generally unobservable and are supported by little or no market activity and that are significant to the fair value determination of the assets or liabilities.

As at September 30, 2010, the Company does not have any derivative and non-derivative instruments which have been designated as hedging instruments.

The following table presents information about the fair value of the Company's derivative and non-derivative financial instruments not designated as hedging instruments and measured at fair value on a recurring basis:

	September 30, 2010	Fair value hierarchy	Balance sheet classification
Assets			
Currency contracts	\$ 6.6	2 ¹	Prepays and other
Currency contracts	1.4	2 ¹	Other assets
	\$ 8.0		

Fair value of the Company's derivatives is classified under Level 2 (inputs that are observable directly or indirectly) as it is measured as follows:

- 1 The fair value of forward currency contracts is measured using the discounted difference between contractual rates and market future rates. Interest rates, forward market rates and volatility are used as inputs for such valuation techniques. The Company incorporates credit valuation adjustments to appropriately reflect both its own non-performance risk and the counterparty's non-performance risk in the fair value measurements.

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The following tables present information about the effects of the Company's derivative instruments designated previously as hedging instruments until April 1, 2010 when hedge accounting was discontinued (refer to note 3) on the Company's consolidated financial statements:

	Gain (loss) recognized in AOCI ¹		(Gain) loss reclassified from AOCI ¹		Classification on Statement of earnings (loss) reclassified from AOCI ¹	Gain (loss) recognized in income ²	
	2010	2009	2010	2009		2010	2009
Three months ended September 30							
Derivatives designated as cash flow hedges							
Currency contracts	\$ –	\$ 7.6	\$ (2.8)	\$ (0.8)	Sales	\$ –	\$ 2.1
Derivatives and other instruments designated as net investment hedges							
Long-term debt	\$ 3.5	\$ 12.5	\$ 0.4	\$ 0.7	Foreign exchange gain (loss) on long-term debt	\$ –	\$ –
Nine months ended September 30							
Derivatives designated as cash flow hedges							
Currency contracts	\$ 4.2	\$ 12.7	\$ (10.0)	\$ 6.9	Sales	\$ (1.8)	\$ 0.4
Derivatives and other instruments designated as net investment hedges							
Long-term debt	\$ 1.0	\$ 21.5	\$ 1.4	\$ 0.7	Foreign exchange gain (loss) on long-term debt	\$ –	\$ –

1 The gain (loss) recognized, or (gain) loss reclassified from AOCI relates to the effective portion of the hedge.

2 The gain (loss) recognized in income relates to the ineffective portion of the hedge and the amount excluded from effectiveness testing.

As U.S. dollar denominated revenues are recognized over the next 12 months subsequent to September 30, 2010, the Company estimates that net gain of \$2.8 million, or an after-tax net gain of \$2.0 million, will be reclassified from *Accumulated other comprehensive income (loss)* to *Sales*.

The carrying value of the Company's other financial instruments, namely cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values because of the short-term maturity of these instruments.

17. FINANCIAL INSTRUMENTS

(a) Financial Risk Management

Financial instruments of the Company consist primarily of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and long-term debt. Financial instruments of the Company also include derivatives which the Company uses to reduce its exposure to currency and price risk associated with its revenues, energy costs and long-term debt.

The Company has exposure to risk from its financial instruments, specifically credit risk, market risk (including currency, price and interest rate risk) and liquidity risk. A summary of the Company's financial risk management objectives can be found on pages 121 to 125 of the Company's 2009 Annual Report.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Accounts receivable

The Company is exposed to credit risk on accounts receivable from its customers who are mainly in the newspaper publishing and commercial printing businesses. Aging of receivables was as follows:

	September 30, 2010	December 31, 2009
Trade receivables, gross		
Current	\$ 98.5	\$ 89.0
Past due 1-30 days	7.8	7.3
Past due 31-90 days	2.1	1.0
Past due over 90 days	0.3	1.4
	108.7	98.7
Allowance for doubtful accounts	(3.1)	(3.7)
Trade receivables, net	105.6	95.0
Other receivables, including GST recoverables	10.7	6.5
Accounts receivable	\$ 116.3	\$ 101.5

The movement in the allowance for doubtful accounts in respect of trade receivables was as follows:

	Nine months ended September 30, 2010	Year ended December 31, 2009
Balance, beginning of period	\$ 3.7	\$ 3.2
Increase (decrease) in provision	(0.6)	1.2
Utilized	-	(0.7)
Balance, end of period	\$ 3.1	\$ 3.7

(b) Revenue Risk Management Instruments

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\$/CDN\$	US\$millions	Average rate US\$/CDN\$	US\$millions	Average rate US\$/CDN\$
As at September 30, 2010						
0 to 12 months	\$ 280	0.9736	\$ 257	0.8744	\$ 14	0.9641
13 to 24 months	36	0.9745	18	0.8800	-	-
	\$ 316	0.9737	\$ 275	0.8748	\$ 14	0.9641
As at December 31, 2009						
0 to 12 months	\$ 270	0.9319	\$ 241	0.8281	\$ 27	0.8729
13 to 24 months	69	0.9590	53	0.8370	-	-
	\$ 339	0.9373	\$ 294	0.8297	\$ 27	0.8729

At period-end exchange rates, the net amount the Company would receive to settle the above contracts and options is \$8.0 million (December 31, 2009 – \$19.0 million).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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The Company no longer designates its U.S. dollar revenue risk management instruments as cash flow hedges for accounting purposes effective April 1, 2010 (note 3). For cash flow hedges that were in place as at March 31, 2010, the effective portion of changes in the fair value accumulated as at March 31, 2010 have been deferred and recorded in *Accumulated other comprehensive income (loss)*. When the hedge item is recorded in earnings, the corresponding gain or loss on the hedge will be reclassified from *Accumulated other comprehensive income (loss)* to *Sales*. At September 30, 2010, instruments having a notional principal of US\$330 million are marked to market, where the related gains and losses are recognized as *Other income (expense), net*, except for the portion still deferred in *Accumulated other comprehensive income (loss)*.

(c) Cost Risk Management Instruments

The Company is party to commodity options to hedge the purchase price of natural gas for 0.9 million gigajoules ("GJ") (December 31, 2009 – 0.4 million GJ) within the next eighteen months at rates averaging \$5.12 per GJ. These instruments are not designated as hedging instruments for accounting purposes and are reported at fair value. At period-end contract rates, the net amount the Company would receive to settle these commodity contracts is \$nil (December 31, 2009 - \$nil).

18. COMPARATIVE FIGURES

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

19. CONTINGENT LIABILITIES

A description of the Company's contingent liabilities as at December 31, 2009 can be found on pages 49 and 50 of the Company's 2009 Annual Report. An update as at September 30, 2010 is outlined below:

(a) Severances

The decision to permanently close the Elk Falls mill resulted in the Company recording \$9.7 million in severances for approximately 120 employees who are expected to be impacted. The recording of this liability in the nine months ended September 30, 2010 has eliminated the contingent severance obligation with respect to these employees.

With the restart of the second line of pulp production at Crofton, Crofton employees who were on lay-offs as at December 31, 2009 have been recalled. This action has eliminated the contingent severance obligation with respect to these employees.

As a result of restructuring and other initiatives announced in prior quarters, there were approximately 50 hourly employees at the Powell River and Port Alberni mills that were on lay-offs and have rights of recall ranging from 13 to 24 months at September 30, 2010. These employees may at any time forfeit their rights of recall in exchange for severance payments. If all affected employees exercise their severance rights at some point and thereby forfeit their recall rights, the total severance payment would be approximately \$2 million. The Company did not record a liability for this contingency as at September 30, 2010 as the likelihood, timing, and extent of any potential liability were not determinable.

(b) Claim for return of payments made to Quebecor World (USA)

In January 2010, Quebecor World (USA)'s litigation trustee ("Quebecor") filed a claim against the Company for alleged preferential transfers of approximately US\$18.8 million. The Company believes it has a number of meritorious defenses and will vigorously defend itself.

(c) Application to Labour Relations Board for Certain Post-retirement Benefits

The CEP Locals 1, 76, 592 and 686 (the "Locals"), representing hourly employees at the Company's Powell River and Port Alberni mills, have applied to the Labour Relations Board of B.C. for a declaration that the Company is responsible for certain post-retirement medical and extended health benefits for some retired employees who were represented by the Locals and who retired from MacMillan Bloedel Limited, now doing business as Weyerhaeuser

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Company Ltd. The Labour Relations Board declined to rule on the Locals' application or the Company's defence to the claim on the basis that this matter is a dispute under the collective agreement and accordingly a matter to be determined by arbitration. At this point, Locals 1, 76 and 592 have filed grievances. The grievance proceeding for Local 76 is expected to take place in December 2010. The other two proceedings have not been scheduled. The extent of the Company's liability for this claim remains unknown at this time although the Company estimates that it would incur costs of between \$2 million and \$4 million annually to provide these additional benefits.

(d) Short-term Incentive Plan Benefit Claim

In May 2010, a salaried employee of the Company commenced an action against the Company in the B.C. Supreme Court seeking a payment under the Company's 2009 Short-term Incentive Plan and damages in connection with the reduction of certain employee benefits. The employee is proposing to seek certification of the action as a class proceeding on behalf of all salaried employees entitled to Short-term Incentive Plan payments and who were affected by the benefit reduction. The Company disputes the claims made and intends to vigorously defend this action and any certification proceedings which may be brought. Given the early stage of these proceedings it is not possible to determine the likelihood, timing and extent of any potential liability. As such, the Company has not recorded a liability for this contingency as at September 30, 2010.

20. RECONCILIATION OF UNITED STATES AND CANADIAN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The Company's consolidated financial statements have been prepared in accordance with U.S. GAAP, which differ in some respects from Canadian GAAP. The following are the significant measurement and disclosure differences between U.S. and Canadian GAAP:

Net Earnings (Loss) Adjustments

The following table provides a reconciliation of the net earnings (loss) for the three and nine months ended September 30 from U.S. GAAP to Canadian GAAP:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Net earnings (loss) as reported under U.S. GAAP	\$ 5.6	\$ 12.3	\$ (407.2)	\$ 29.5
Net (earnings) loss attributable to non-controlling interest (a)	0.4	0.9	0.7	1.9
Amortization related to hedge of net investment (b)	–	–	0.1	0.2
Employee future benefits (c)	(0.1)	–	(0.1)	–
Income tax effect of rate change on employee future benefits	–	–	–	0.7
Net earnings (loss) in accordance with Canadian GAAP	5.9	13.2	(406.5)	32.3
Other comprehensive income (loss), net of taxes:				
Other comprehensive income in accordance with U.S. GAAP	(2.9)	5.0	18.5	16.1
Other comprehensive income (loss) attributable to non-controlling interest (a)	–	–	(0.1)	–
Employee future benefits liability adjustment, net of taxes (c)	–	–	(23.3)	–
Reclassification of amortization of employee future benefits included in pension cost, net of taxes (c)	(0.5)	(1.3)	(1.5)	(2.6)
Comprehensive income (loss) in accordance with Canadian GAAP	\$ 2.5	\$ 16.9	\$ (412.9)	\$ 45.8
Basic and diluted net earnings (loss) per share in accordance with Canadian GAAP (in dollars)	\$ 0.02	\$ 0.03	\$ (1.06)	\$ 0.08
Basic and diluted weighted average number of shares in accordance with Canadian GAAP (in millions)	381.8	381.8	381.8	381.8

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Balance Sheet Adjustments

The following table provides a reconciliation of the consolidated balance sheet components from U.S. GAAP to Canadian GAAP:

	September 30, 2010	December 31, 2009
Prepays and other – U.S. GAAP	\$ 29.9	\$ 25.2
Deferred financing costs (d)	(0.1)	–
Prepays and other – Canadian GAAP	\$ 29.8	\$ 25.2
Property, plant and equipment – U.S. GAAP	\$ 1,315.4	\$ 1,664.7
Foreign exchange gain on hedge of net investment, net of amortization (b)	(2.1)	(2.2)
Property, plant and equipment – Canadian GAAP	\$ 1,313.3	\$ 1,662.5
Other assets – U.S. GAAP	\$ 39.3	\$ 38.0
Employee future benefits (c)	35.2	35.2
Tax effect of employee future benefits adjustment	(1.2)	(1.9)
Deferred financing costs (d)	(10.9)	(6.6)
Non-controlling interest deficit (a)	19.4	18.0
Other assets – Canadian GAAP	\$ 81.8	\$ 82.7
Accounts payable and accrued liabilities - U.S. GAAP	\$ 172.7	\$ 173.3
Employee future benefits (c)	(3.2)	–
Accounts payable and accrued liabilities - Canadian GAAP	\$ 169.5	\$ 173.3
Long-term debt – U.S. GAAP	\$ 807.7	\$ 774.6
Deferred financing costs (d)	(11.0)	(6.6)
Long-term debt – Canadian GAAP	\$ 796.7	\$ 768.0
Employee future benefits – U.S. GAAP	\$ 253.5	\$ 294.6
Employee future benefits (c)	(22.4)	(59.0)
Employee future benefits – Canadian GAAP	\$ 231.1	\$ 235.6
Future income taxes – U.S. GAAP	\$ 26.6	\$ 22.8
Tax effect of employee future benefits adjustment	23.6	31.4
Tax effect of other adjustments	(9.1)	(9.1)
Future income taxes – Canadian GAAP	\$ 41.1	\$ 45.1
Equity – U.S. GAAP	\$ 406.2	\$ 795.6
Foreign exchange gain on hedge of net investment, net of amortization (b)	(2.1)	(2.2)
Employee future benefits (c)	60.8	94.2
Tax effect of employee future benefits adjustment	(24.8)	(33.3)
Tax effect of other adjustments	9.1	9.1
Non-controlling interest deficit (a)	19.4	18.0
Equity – Canadian GAAP	\$ 468.6	\$ 881.4

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The following table provides a reconciliation of AOCI from U.S. GAAP to Canadian GAAP:

	September 30, 2010	December 31, 2009
Accumulated other comprehensive income (loss) – U.S. GAAP	\$ (34.3)	\$ (52.7)
Employee future benefits (c)	36.1	60.9
Accumulated other comprehensive income (loss) – Canadian GAAP	\$ 1.8	\$ 8.2

(a) Non-controlling Interest

Under U.S. GAAP, non-controlling interest's equity or deficit is reported as a separate component within equity of the consolidated balance sheet and consolidated net earnings (loss) and other comprehensive income (loss) attributable to the Company and to the non-controlling interest is clearly identified and presented on the face of the consolidated statements of earnings (loss), comprehensive income (loss), and equity. Under Canadian GAAP, the Company includes non-controlling interest's equity or deficit in *Other assets* and the non-controlling interest's share of earnings or loss is excluded from consolidated net earnings (loss).

(b) Foreign Exchange on Hedge of Net Investment

Under U.S. GAAP, the foreign exchange gain on a hedge of a net investment is recognized in earnings, and accordingly, the net investment acquired is not reduced by the amount of the gain. Under Canadian GAAP, the Company designated a forward contract as a hedge of the purchase price on the acquisition of the Snowflake newsprint mill, and accounted for the respective foreign exchange gain as a reduction of the net investment.

(c) Employee Future Benefits

U.S. GAAP requires the recognition of the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in the balance sheet and requires that changes in that funded status in the year in which the changes occur be recorded in *Other comprehensive income (loss)*. As a result, as amounts that relate to the funded status are recognized in earnings through pension expense, the amounts are reclassified out of AOCI. Canadian GAAP does not require recognition of the overfunded or underfunded status of a defined benefit post-retirement plan. There is no GAAP difference between U.S. and Canada in the determination of pension and other employee future benefits expense.

(d) Deferred Financing Costs

Under U.S. GAAP, debt issue costs are reported on the balance sheet as deferred charges in *Other assets*. Under Canadian GAAP, debt issue costs related to the Company's senior notes and non-recourse first mortgage bonds are netted against the carrying value of long-term debt on the consolidated balance sheet.

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