Canadian Pacific Forest Products Limited

ANNUAL

REPORT

1989

Corporate Profile

Canadian Pacific Forest Products Limited is one of the world's largest integrated forest products corporations. It manufactures a wide range of forest products including newsprint and uncoated mechanical paper, pulp, paperboard and packaging materials, white paper, tissue products and lumber. The Corporation's sales were $2.9 billion in 1989, and total assets at year-end exceeded $3 billion.

The Corporation is one of the largest newsprint producers in the world, with mills supplying publishers in more than 35 countries. In market pulp production, it ranks first in Canada and is one of the largest producers in the world. With some 10 million hectares of forests, it is the largest holder of timber cutting rights in Ontario and a major forest landowner in British Columbia, Quebec and New Brunswick. The Corporation's mills are located in Dalhousie, New Brunswick; Trois-Rivières, La Tuque, Gatineau and Matane, Quebec; Thunder Bay and Dryden, Ontario; Gold River, British Columbia; and Usk, Washington. In addition, the Corporation operates one tissue mill, 11 converting plants and five sawmills, all strategically located throughout Canada.

The Corporation exports to customers in more than 40 countries, with its largest market in the United States. It is well placed to supply newsprint, pulp and wood products to all parts of the world. It has a network of offices providing marketing and customer services in Canada, with additional offices in Atlanta, Chicago, Indianapolis, New York, Seattle, London, Tokyo and Zurich. The Corporation has executive offices in Montreal, Thunder Bay and Vancouver.

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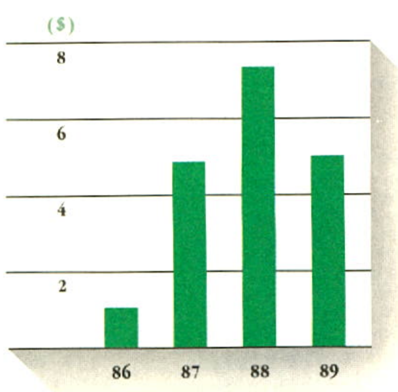
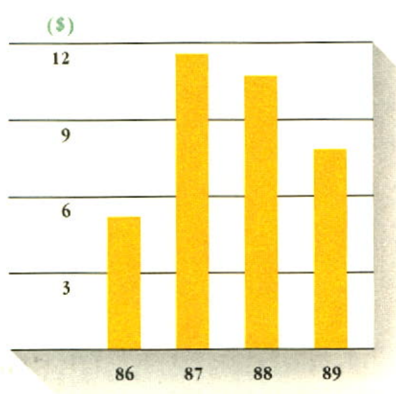
Canadian Pacific Forest Products Limited is using the cover of the 1989 Annual Report to publicly introduce its new logo, a design which symbolizes the Corporation, its products and markets. The circle represents the Corporation's global presence; the curves represent the growth rings in the cross-section of a tree as well as rolls of paper; and the tree in the centre is the source of all of the Corporation's products.

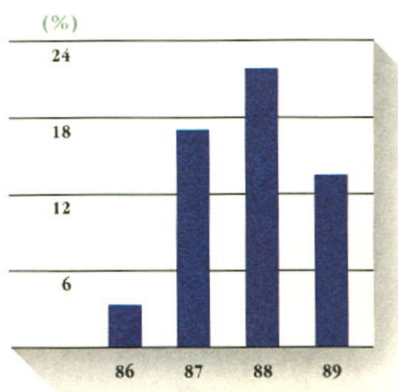
(in millions of dollars, except per share amounts)	1989	1988	1987	1986
Sales	$2,876.4	$3,005.9	$2,764.7	$2,316.7
Operating Earnings	377.1	587.4	476.6	215.6
Net Earnings	220.1	323.4	214.0	33.3
Total Assets	3,071.3	2,774.4	2,669.4	2,542.7
Long-Term Debt	330.7	114.7	337.5	778.1
Shareholders' Equity	1,690.7	1,584.9	1,362.3	1,154.6
Net Earnings per Share	5.01	7.36	4.87	1.08
Cash Flow per Share	7.85	10.70	11.62	5.21
Return on Equity	13.4%	21.9%	17.0%	3.3%



Net Earnings per Share



Cash Flow per Share

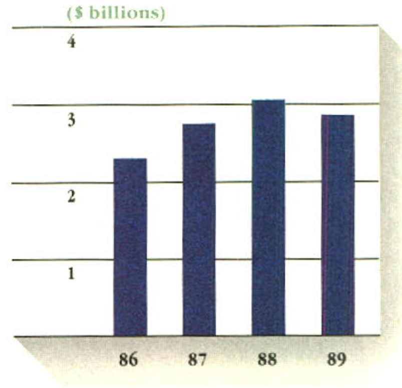


Return on Shareholders' Equity

The Corporation achieved considerable success in 1989. Whereas in 1988 almost all business segments of the Corporation enjoyed relative strength and combined to produce a record year, in 1989 some cyclicality, typical of the forest products industry, overtook the paper and solid wood products segments. This was particularly true for newsprint, the Corporation's principal product. However, bleached kraft pulp experienced a record year and along with tissue products sustained a substantial level of earnings and cash flow. The increased value of the Canadian dollar in 1989 versus the U.S. dollar and other foreign currencies had a significant unfavourable impact on earnings.

The Corporation carried out a record year of capital spending with the successful start-up of a new white paper machine in Dryden, Ontario, the completion of the two joint venture newsprint mills at Usk, Washington, and Gold River, British Columbia, and substantial progress in the construction of the new newsprint machine and thermomechanical pulp mill at Thunder Bay, Ontario. All of this was achieved while maintaining the debt-equity structure of the Corporation well within acceptable levels.

In December 1989, the Corporation announced, as part of its ongoing capital investment program, a $175-million investment to enable it to provide quality recycled-content newsprint to its North American customers from its newsprint mills in Gatineau, Quebec and Thunder Bay. With the completion of this project in mid-1991, the Corporation will be well positioned to play a leadership role in this developing market.



Sales

FINANCIAL RESULTS

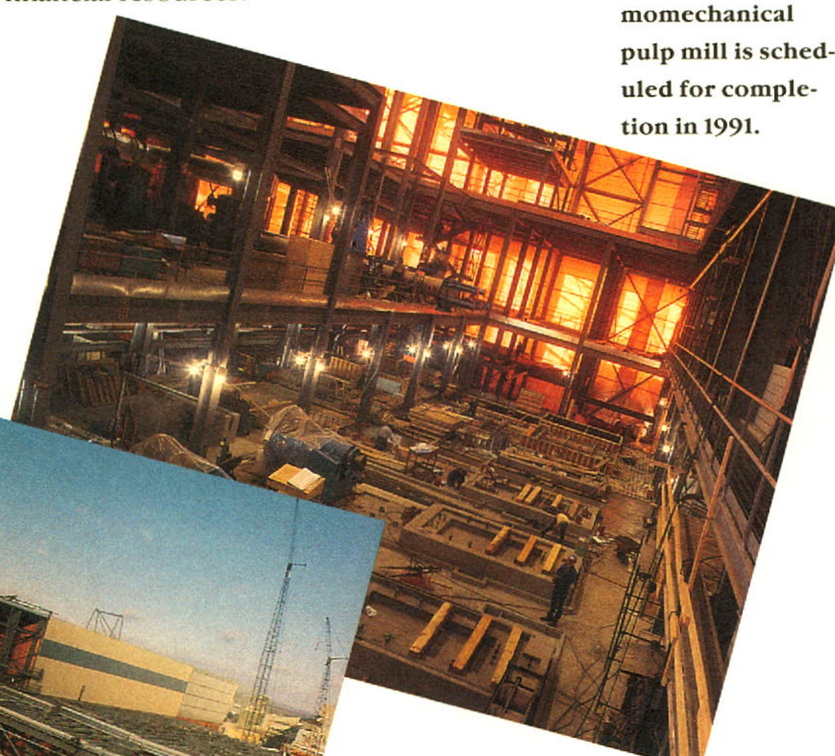
Net earnings in 1989 were $220.1 million or $5.01 per share, compared with net earnings of $323.4 million or $7.36 per share in 1988, a decrease of 32 percent. Sales in 1989 totalled $2.9 billion compared with $3 billion a year ago. The reduction in net earnings resulted primarily from soft market conditions for newsprint and the higher exchange value of the Canadian dollar compared with the U.S. dollar and other foreign currencies. Other contributing factors to the earnings decline were weaker markets in paperboard, packaging products and white paper. The weakness in these markets, as well as in newsprint, was in part offset by continuing strong demand in the pulp market.

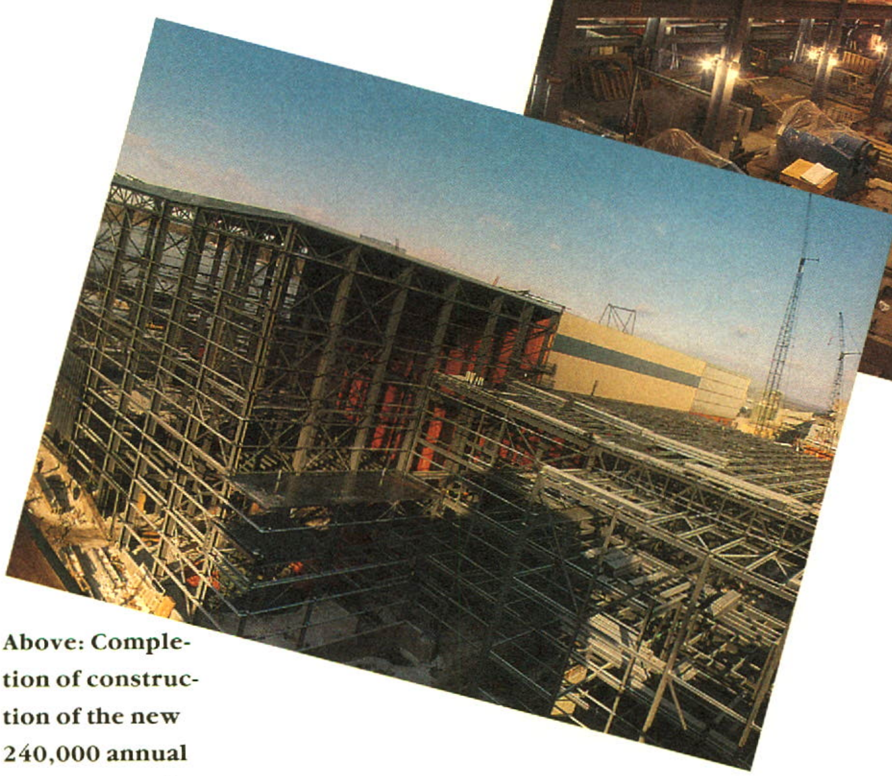
More than half of the Corporation's sales are made in U.S. dollars. The Canadian dollar averaged approximately 85 cents U.S. in 1989 compared with 81 cents U.S. in 1988. Each one U.S. cent annual change in the value of the Canadian dollar resulted in a change in net earnings of approximately $15 million or about 34 cents a share.

BUILDING FOR THE FUTURE

In 1989, we made great strides in providing a strong foundation for the future growth of the Corporation. We have made substantial progress in our capital expenditure program with the start-up in 1989 of three world-scale, state-of-the-art paper machines. We are very proud of this achievement which we believe is unique for the Canadian industry and which underlines the strength of the Corporation in terms of human and financial resources.

Below: Construction of the 245,000 annual tonne Thunder Bay thermomechanical pulp mill is scheduled for completion in 1991.





Above: Completion of construction of the new 240,000 annual tonne newsprint machine in Thunder Bay, Ontario is scheduled for 1991.

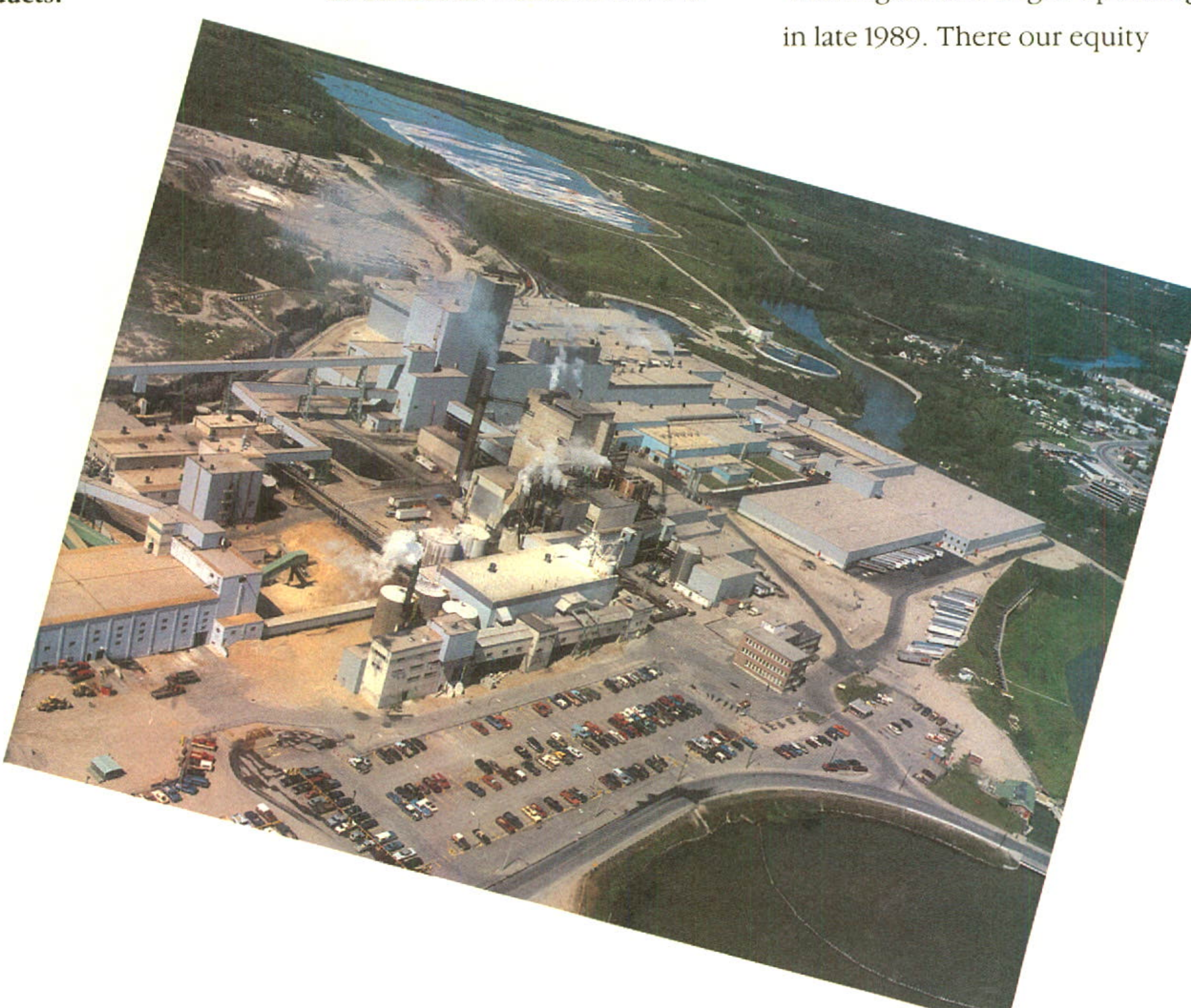
Below: Our forward integration into white paper at Dryden, Ontario underlines the Corporation's commitment to manufacture high quality, value-added products.

The key components of our capital expenditure program which were addressed in 1989 are as follows:

• The new $175-million, 175,000 annual tonne white paper machine at Dryden started up in late June. We will continue to build on Dryden's high quality reputation and concentrate marketing efforts on high growth business grades in Canadian and U.S. markets. The increased capacity at Dryden will allow expansion of our customer base in Canada as well as in the U.S. market where the elimination of tariffs on white paper under the Free Trade Agreement will enhance export possibilities.

• At Gold River, operations at our joint venture $323-million, 230,000 annual tonne newsprint mill commenced in late 1989. The new facility features the latest in papermaking technology. Our equity commitment is $78 million.

• The joint venture $330-million U.S., 210,000 annual tonne Ponderay newsprint mill at Usk, Washington also began operating in late 1989. There our equity



Right: The 210,000 annual tonne Ponderay greenfield mill complex on 900 acres in Usk, Washington is well positioned to serve U.S. West Coast markets.

commitment is $44 million U.S. The start-up proceeded extremely well and shipments of superior quality newsprint began in December.

• The $350-million modernization program at the Thunder Bay newsprint mill is our single largest capital commitment. Construction of a 245,000 annual tonne thermo-mechanical pulp mill and a new, 240,000 annual tonne newsprint machine is proceeding on schedule. This investment will allow us to meet the most stringent requirements in terms of quality.

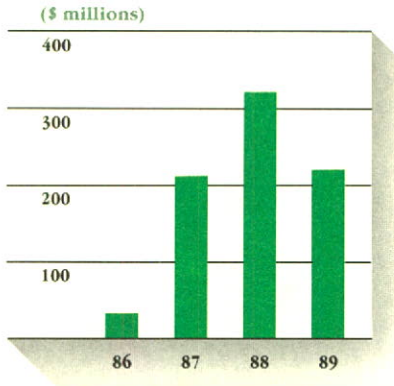
• The program to provide quality recycled-content newsprint to North American customers from our Gatineau and Thunder Bay mills will bring these two facilities into the forefront of papermaking technology while responding to public concern over the volume of old newspapers in municipal solid waste sites.

• Our ability to produce recycled-content newsprint, as well as other high quality products, while providing excellent customer service will give the Corporation an important competitive edge in the coming years.

With the addition of the Gold River and Ponderay mills, our Corporation has become the only newsprint producer positioned to serve customers from coast to coast in North America as well as offshore. We also expect new market opportunities in Western North America for the mills' superior quality newsprint, as well as increased market share in Europe and the Pacific Rim.

• Concurrent with these major projects has been a significant upgrade of our sawmill facilities on the West Coast to improve productivity and efficiency, add value to our products and allow us to take advantage of new opportunities in the international market-place.

In addition to our current capital expenditure program, we are in the process of reviewing our operations through market-driven analysis to determine the products that we can best supply and that optimize our fibre base. Our objective is to produce a wide range of high quality, value-added products, ensure customer satisfaction, reduce costs, and improve our ability to compete effectively. The forward integration into white paper at Dryden with the new machine started up in 1989 is a prime example of this strategy.



Net Earnings

We also continually seek opportunities where process changes and technological advances in existing mills could enhance product quality, plant efficiency and environmental performance. Such improvements may require a substantial amount of capital over the coming decade but we believe this can be managed to match the cash flow expectations and financial resources available to the Corporation.

In our pulp business, we expect growth in market demand and continued favourable operating rates in 1990.

In paperboard and packaging, product diversification and new higher value-added and specialty grades are key objectives in the bleached board and container board categories. A greater variety and volume of bleached and composite boards will be used for liquid packaging. Recycled fibre use is also expected to increase.

In the tissue business, we plan to take advantage of opportunities presented by the Free Trade Agreement to expand our business in U.S. markets. Other key objectives include a higher market share in Canadian commercial and industrial markets, pursuit of profitable elements of the private label business, as well as growth opportunities for the Corporation's professional products.

Below: With the addition of the 230,000 annual tonne Gold River, British Columbia joint venture newsprint mill, the Corporation has six newsprint mills coast to coast well positioned to serve North American and overseas markets.

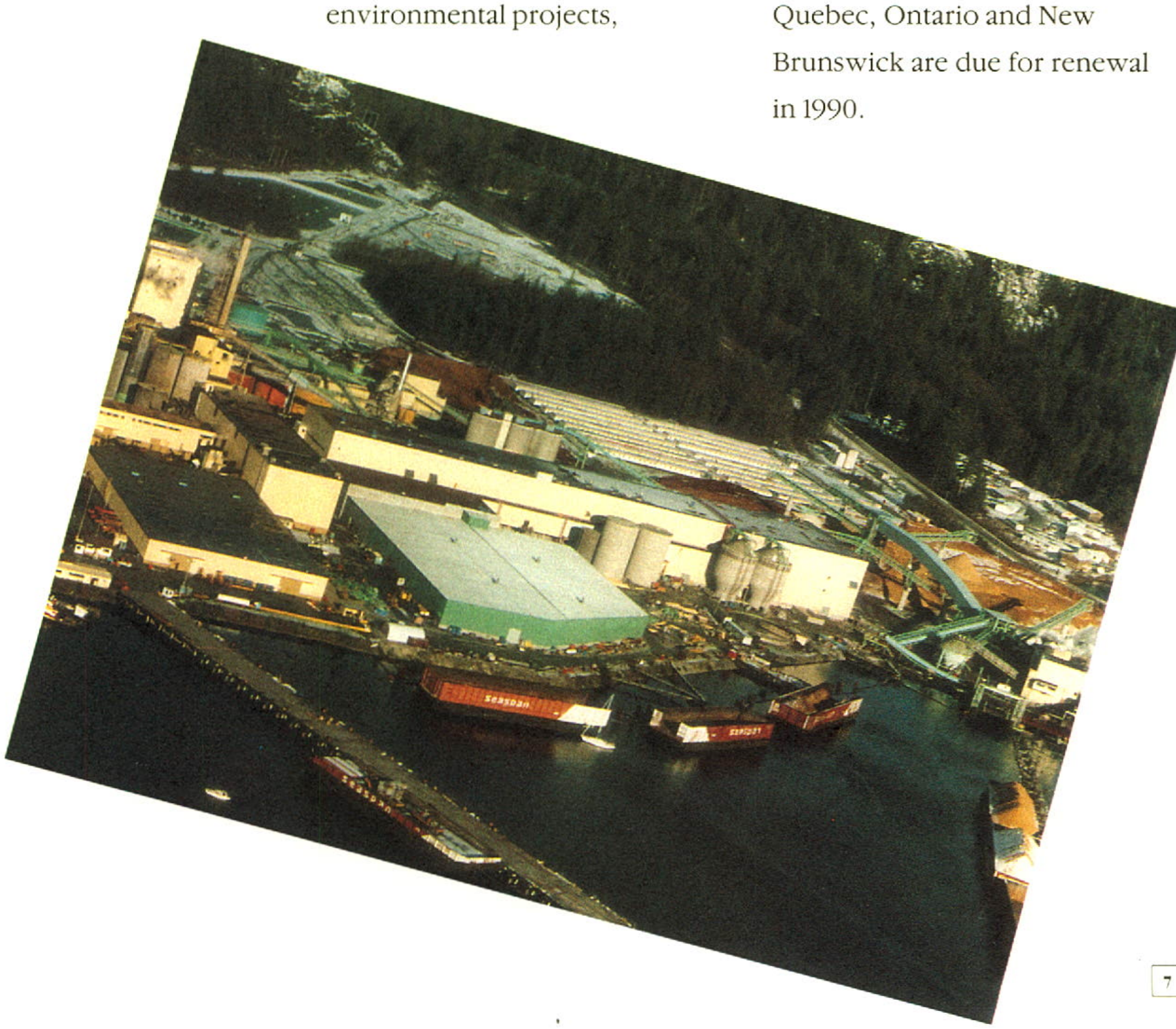
ENVIRONMENT

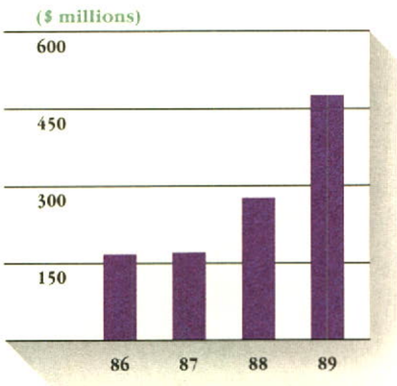
Environmental protection continues to be a major corporate responsibility as reconfirmed by the recent adoption by the Board of Directors of a Corporate Environmental Protection Policy. This Policy reflects Canadian Pacific Forest Products' continuing respect for the environment, as well as the ongoing commitment of the Corporation's directors, officers and employees to the protection of the environment. The Corporation has committed, over the period 1989 through 1992, $145 million to environmental projects, some of which are described in more detail in the Environment section of the Review of Operations.

LABOUR AGREEMENTS

In 1989, five collective agreements were renewed for three-year periods for converting operations in Eastern Canada and marine log towing operations in British Columbia.

With the exception of British Columbia where labour agreements are in effect until 1991, the majority of the collective agreements for the primary operations and woodlands situated in Quebec, Ontario and New Brunswick are due for renewal in 1990.





Capital Expenditures

FINANCING

In the fourth quarter of 1989, the Corporation issued $125,000,000 in unsecured debentures maturing in 25 years. Priced at par, the debentures bear interest at 10.85 percent per annum, payable semi-annually. The debentures were rated A (high) by the Canadian Bond Rating Service and A by the Dominion Bond Rating Service. Proceeds have been used to reimburse part of the Corporation's long-term bank loans primarily incurred to finance the capital expenditure program. The success of this 25-year issue is an indication of Canadian lenders' confidence in the future of the Corporation.

APPOINTMENTS

Mr. Paul E. Gagné was elected a Director and appointed President and Chief Operating Officer of the Corporation by the Board of Directors at its meeting held on February 2, 1990.

The following appointments were also approved by the Board of Directors at that meeting: Mr. David G. Toole as Senior Vice-President, Finance, Accounting and Logistics; Mr. Wayne B. Wolfe as Senior Vice-President, Manufacturing and Woodlands Operations; and Mr. Donald A. Bridges as Vice-President, Converting.

At the November 29, 1989 Board of Directors' meeting, Mr. Keith E. Winrow, Vice-President, was given the additional responsibility of Comptroller.

OUR FUTURE

Our success in the 1990s will be measured by our ability to lead in product quality, customer satisfaction, higher productivity and low cost facilities, and to respond to the evolving needs

Left to right: F. D. Quinn, Vice-Chairman; P. E. Gagné, President and Chief Operating Officer; C. S. Flenniken, Chairman and Chief Executive Officer; J. H. Whalen, Executive Vice-President, Marketing; and R. E. Chambers, Executive Vice-President and President, Great Lakes and Tahsis Pacific Regions.

and demands of the population and market-place with respect to the environment. We have taken major steps in 1989 to put in place the resources necessary to meet these challenges, and to deal with the market changes and opportunities created by the Free Trade Agreement and industry concentration.

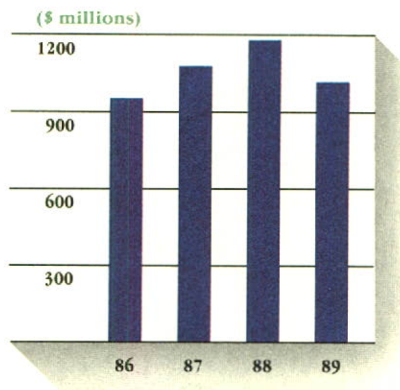
I would like to thank all of our employees for their dedication and hard work during a challenging year. We should all be proud of our progress and confident of our future success. Together, we are building for our future.

On behalf of the Board of Directors,

Cecil S. Flenniken
Chairman and Chief Executive Officer

Montreal, March 16, 1990

Despite healthy growth in overseas markets, the Corporation's newsprint business experienced a disappointing year, with operating earnings decreasing by 91 percent from 1988 levels. Total newsprint sales decreased to $1,017.5 million, compared with $1,189.8 million in 1988. Reduced earnings from sales to the United States, which account for about 71 percent of the Corporation's newsprint business, were largely due to substantial discounting of newsprint prices and to the higher value of the Canadian dollar versus the U.S. dollar.



Newsprint Sales

OPERATIONS

In 1989, the newsprint mills at Trois-Rivières and Gatineau, Quebec operated at less than available capacity, with extended shutdowns due to reduced market demand. The Thunder Bay, Ontario and Dalhousie, New Brunswick mills operated at capacity.

Construction of the thermomechanical pulp mill and a new newsprint machine at Thunder Bay, a total capital investment of $350 million, is proceeding on schedule. Further conversion to twin-wire production was carried out at the Dalhousie mill in late 1989.

Construction was completed and operations commenced at the Corporation's new Ponderay and Gold River joint venture mills in late 1989. Shipments of superior quality newsprint to the Ponderay partners began in December 1989 and to the Gold River partners in January 1990.

MARKETS

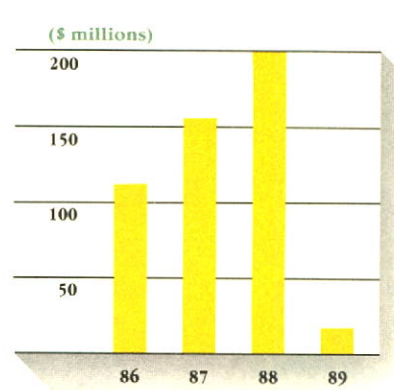
Competitive market pressures resulting from new capacity, slow economic growth and the concentration of publisher ownership in North America caused widespread price discounting in 1989. Lower customer inventories also contributed to reduced demand.

Overseas demand for standard grade newsprint improved in 1989, growing seven percent in the United Kingdom, six percent in Japan, and eight percent in continental Europe. Competition intensified in Southeast Asia, Latin America and the Middle East, as a result of North American suppliers seeking new markets to compensate for the declining North American demand.

In response to the growing uncoated mechanical paper market, the Corporation focused on the development of higher value products such as uncoated mechanical copy paper, and the introduction of new technology such as soft calendering and on-machine coating.

OUTLOOK

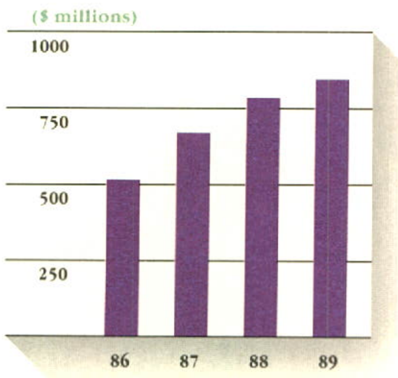
Standard newsprint markets in North America are expected to grow by one percent in 1990, while uncoated mechanical paper markets should grow by three percent. Overseas markets will likely become more competitive due to increasing capacity offshore.



Newsprint Operating Earnings

Delivery of high quality newsprint is essential to meet the growing demands of newspaper publishers who are using innovative styling, colour and graphics.

Bleached softwood kraft pulp enjoyed strong demand in 1989 and demand for hardwood kraft pulp remained firm for most of the year. The performance of these products, manufactured at mills in La Tuque, Quebec, Dryden and Thunder Bay, Ontario and Gold River, British Columbia contributed significantly to the Corporation's overall performance in 1989. Sales for 1989 totalled $849.2 million compared with



Pulp Sales

$790.9 million in 1988. Operating earnings totalled $323 million compared with $279.4 million in 1988.

OPERATIONS

The Thunder Bay, Ontario facility achieved high productivity and low operating costs throughout the year. All kraft pulp mills except La Tuque, Quebec ran at capacity in 1989. Mechanical problems occurred at the La Tuque mill during the year, reducing the mill's productivity and contributing to higher operating costs.

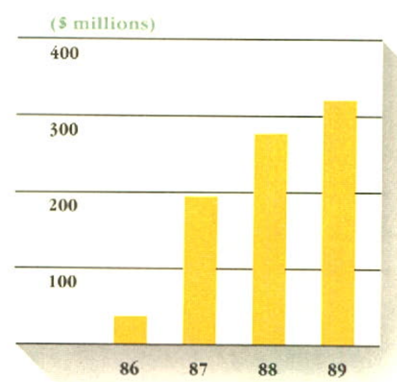
MARKETS

Northern softwood bleached market kraft pulp, the Corporation's principal pulp product, enjoyed strong markets in 1989. Industry shipments were high during the year and producers' inventories were below normal levels. The Corporation's market kraft pulp shipments for the first half of 1989 were higher than in the corresponding period last year. A slight reduction in sales took place in the second half in order to meet the demands of the Corporation's new white paper machine in Dryden.

While some pricing improved in the North American market, earnings on U.S. shipments were significantly affected by the higher value of the Canadian dollar versus the U.S. dollar. Favourable market conditions allowed pricing to improve in overseas markets.

OUTLOOK

Northern softwood bleached kraft pulp has experienced limited capacity additions and, consequently, it is the grade with the strongest potential over the near term. Hardwood kraft, southern softwood kraft and mechanical pulps are expected to become increasingly available over the next few years and northern softwood kraft producers should maintain higher operating rates than hardwood, southern softwood and mechanical pulp producers. The Corporation anticipates continued favourable operating rates for most of its pulp producing facilities.



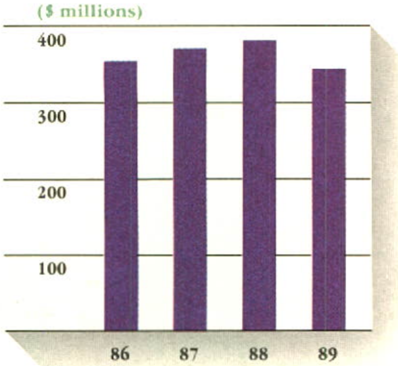
Pulp Operating Earnings

An operator at the bale-weighing station in the Dryden, Ontario mill checks the weight of fully-bleached kraft pulp bales.

The paperboard and packaging segment faced a progressively weaker market in 1989. Paperboard volumes and average prices decreased due to difficult market conditions, especially in Eastern Canada. Sales totalled $348 million compared with $387 million in 1988. Operating earnings in 1989 were $30.5 million compared with $57.4 million in 1988.

OPERATIONS

Mechanical problems at the La Tuque, Quebec mill led to lower production volumes and higher operating costs, and linerboard production was temporarily shut down in December in order to adjust supply to customer demand. The softening paperboard market also resulted in three shutdowns at the Matane, Quebec corrugating medium mill.



Paperboard and Packaging Sales

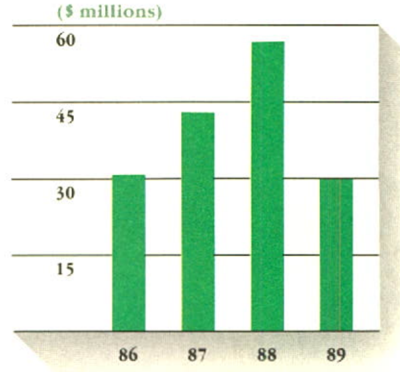
A new press was installed in the Corporation's Pure-Pak® carton plant in St-Léonard, Quebec to increase production capacity as well as improve product quality and customer service.

New rotary die-presses were installed in the Burlington, Ontario and Montreal, Quebec container plants and state-of-the-art press feeders were installed in almost all of the Container Division plants as part of a quality and productivity improvement program.

MARKETS

The U.S. market demand for linerboard and corrugating medium was relatively stable in 1989, but demand was weak in Eastern Canada. Decreased Canadian demand was due to reduced economic activity and this, combined with increased U.S. imports resulting from lower tariffs under the Free Trade Agreement and the higher value of the Canadian dollar relative to the U.S. dollar, created weak markets for domestic suppliers. Consequently, linerboard, corrugating medium and corrugated container prices were under pressure for most of the year.

The supply and demand balance for bleached board was favourable in 1989, as no new capacity was available. Despite full operation, the bleached board machine at the La Tuque mill could not meet market demand and customers were frequently on allocation. Demand for cupstock, baconboard and folding carton grades was strong, and milk carton demand was steady. Price increases were realized on all grades of bleached board.



Paperboard and Packaging Operating Earnings

OUTLOOK

Demand for paperboard and packaging products in 1990 is expected to parallel the weakening economic conditions forecast for North America.

High quality paperboard to meet the stringent graphic and printing requirements of customers is manufactured at mills in La Tuque and Matane, Quebec.

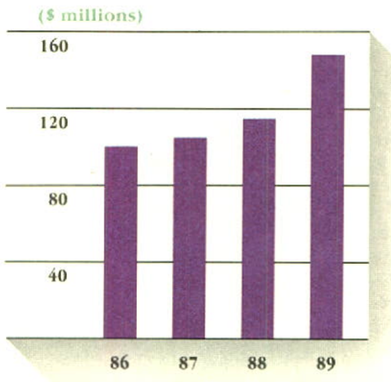
Demand for white paper started to weaken in the first quarter of 1989, with the trend accelerating during the second and third quarters. Many producers experienced machine downtime during the summer, as mill inventories rose, order backlogs declined and demand became very sluggish. However, some improvement was experienced during the latter part of the year. Sales amounted to $149 million compared with $115.6 million in 1988. Operating earnings in 1989 were $7.2 million compared with $13.6 million in 1988.

OPERATIONS

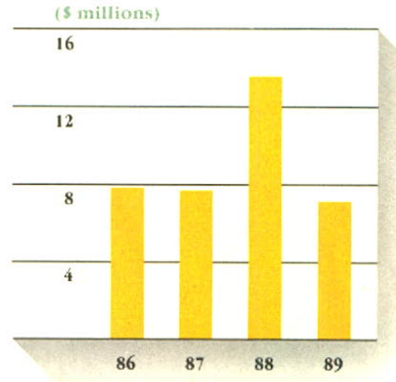
Production levels in the first six months of 1989 were relatively uniform.

In April, the Dryden, Ontario mill operation converted from acid to alkaline papermaking, consistent with a North American industry trend made possible by new technology. Alkaline papers offer excellent archival qualities for text books, reference materials and other products where permanence is important.

On June 28, 1989, the first paper was produced on the Corporation's state-of-the-art, $175-million white paper machine at Dryden. This machine brings the papermaking capacity of the mill to 285,000 tonnes annually. The new machine experienced a relatively smooth start-up and it was officially commissioned on September 18, 1989. In conjunction with the new paper machine, North America's largest cut-to-size sheeter was installed with duplicate labelling, packaging and carton filling lines. A major upgrade of the Corporation's on-line computerized order entry system was also completed, concurrent with these installations, linking the Toronto, Ontario and Indianapolis, Indiana sales offices with the mill in Dryden.



White Paper Sales



White Paper Operating Earnings

MARKETS

Consumption in 1989 was approximately equal to that of 1988. The lack of growth in demand, as well as new capacity entering the market-place, led to an increased prevalence of price discounting, primarily during the second and third quarters.

OUTLOOK

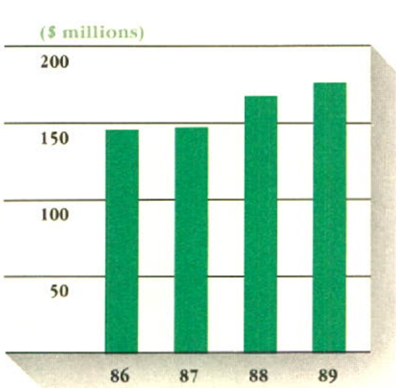
The white paper market is expected to start growing again, but at a moderate pace due to slow economic growth.

The Corporation's new white paper machine in Dryden, Ontario offers high quality white paper of various basis weights to suit the diverse requirements of customers.

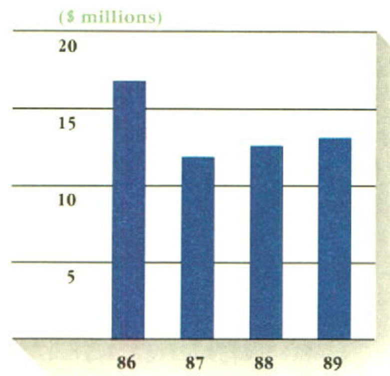
The year 1989 marked the 60th anniversary of Facelle Company Limited, a wholly-owned subsidiary of the Corporation. Originally a two-person operation, the tissue business today employs over 575 and Facelle sells in all ten provinces, as well as in the states of New York, Michigan and Ohio. Facelle's brand names include Royale, Florelle, Facettes, Pronto, Dove and Festival. In 1989, tissue product sales totalled $177.7 million compared with $167.9 million in 1988. Operating earnings for the year reached $13.2 million compared with a total of $12.6 million in 1988.

OPERATIONS

Tissue production fluctuated during 1989, in response to changing market demand. Despite these variances, total tissue production was higher than the previous year, and the Toronto, Ontario operation was successful in achieving favourable production costs.



Tissue Sales



Tissue Operating Earnings

Current capital plans, representing an investment of $20.2 million, include increasing the capacity of one of the paper machines to accommodate heavier weight grades of tissue at higher production rates, as well as increasing tissue production capacity to allow the Company to fill steadily growing market demand for its popular Royale and Florelle facial tissue products.

MARKETS

Sales of tissue products experienced a slow start in 1989, as a result of some advance buying at the end of 1988, in anticipation of the January 1, 1989 price increase. The market recovered during the second half, resulting in a six per cent improvement in sales over the previous year.

A line of serviettes named Festival was introduced nationally in January of 1989. Market penetration exceeded expectations over the year.

In the professional products sector, Facelle supplies more than 80 percent of the hospital wipes in Canada and about 95 percent of the barber towels. These two products represent more than two thirds of Facelle's professional product sales.

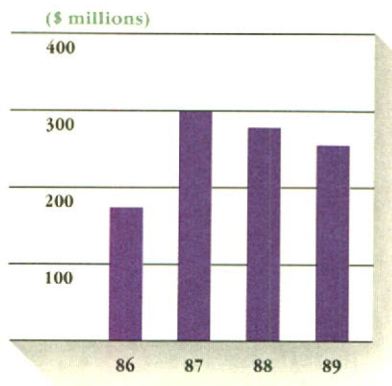
Facelle has established a presence for its branded products in the states of New York and Ohio, and is creating additional distribution outlets to expand in these and other states where there is potential for profitable returns.

OUTLOOK

In 1990, Facelle Company Limited expects to achieve additional market growth in its facial tissue, bathroom tissue, towel and serviette lines.

For sixty years, consumers have depended on Facelle for a wide range of high quality products to suit their families' needs.

During most of 1989, lumber markets were weak in North America, with the only real growth opportunities being offered by export markets. Low production levels at the Tahsis and Ladysmith, British Columbia and Thunder Bay and Dryden, Ontario sawmills were partially offset by higher selling prices. Sales in 1989 totalled $258 million compared with $280.6 million in 1988. Operating losses totalled $12.8 million compared with operating earnings of $16.5 million in 1988.



Lumber and Other Wood Products Sales

OPERATIONS

The Corporation has invested $58 million in the past four years in a major capital program to upgrade and modernize its lumber manufacturing facilities in British Columbia in order to maximize lumber yield and value recovery, consistent with both timber supply and marketing programs.

The new $28.4-million large log mill at Tahsis, which replaces an older Tahsis facility began production in July, two months ahead of schedule. The mill is now better positioned to compete in overseas markets. At the Ladysmith sawmill, $7.4 million was invested to increase the mill's ability to handle a full range of small diameter logs.

Mayo Forest Products Ltd., a subsidiary in Nanaimo, British Columbia jointly owned with Mitsubishi Corporation, focused on improving lumber recovery and increasing value from the large log component of the timber resource.

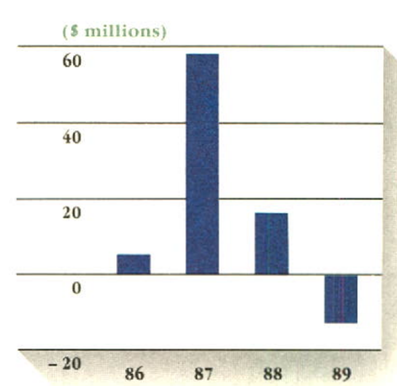
The sawmills in Thunder Bay and Dryden manufacture kiln-dried framing lumber called studs. In 1989, efforts continued to improve recovery and to produce specialty items.

MARKETS

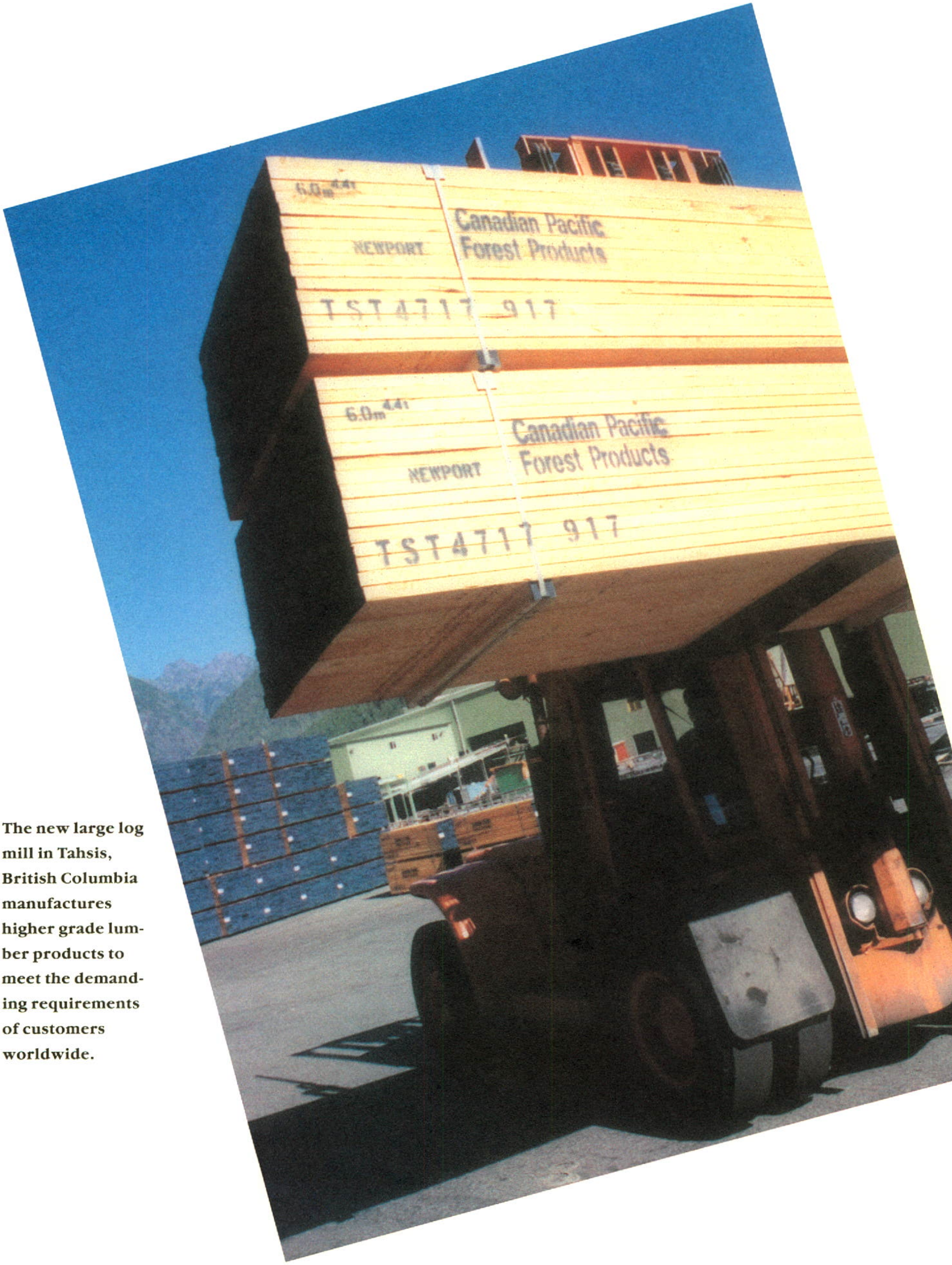
The West Coast's marketing strategy focused on reducing dependency on the North American commodity market. Programs were designed to establish direct communications links with overseas customers, and tailor products specifically to the needs of end users.

OUTLOOK

North American lumber markets will likely remain flat in early 1990, while steady demand and favourable prices are anticipated in offshore markets. By the end of 1990, U.S. lumber consumption is expected to recover, offsetting expected deterioration in Canadian markets.



Lumber and Other Wood Products Operating Earnings



The new large log mill in Tahsis, British Columbia manufactures higher grade lumber products to meet the demanding requirements of customers worldwide.

Canadian Pacific Forest Products manages some 10 million hectares (25 million acres) of forests across Canada. These forests provide in excess of 50 percent of the Corporation's total wood supply, with the remaining requirements purchased from independent sources. The Corporation's woodlands are located in the provinces of New Brunswick, Quebec, Ontario and British Columbia.

An inherent part of the Corporation's forest management program is a commitment to the responsible harvesting of its woodlands and, most essential, to their renewal. The Corporation works with provincial forestry ministries on an ongoing basis in determining the extent and nature of its harvesting activities and reforestation responsibilities within each province.

Canadian Pacific Forest Products has a long-standing commitment to responsible forest management. Over twenty years ago, the Corporation was dedicated to sustaining its forests, planting hundreds of thousands of seedlings annually. In 1989, Canadian Pacific Forest Products planted over 32 million seedlings in its woodlands operations across Canada, to complement naturally occurring regeneration. As these seedlings grow to maturity, they require ongoing attention, including thinning to reduce overcrowding and protection from competing vegetation, fire, insects and disease.

The Corporation's first forestry centre was established in Harrington, Quebec in 1952. Today, the Corporation's forestry centres in Harrington, Quebec, Thunder Bay, Ontario and Saanich, British Columbia are devoted to year-round silvicultural research including the development of genetically superior seed for faster growth and higher quality trees.

Each forestry centre concentrates on the research and development of species appropriate to its region. In 1989, the Harrington seed orchard produced the first seeds from its tree improvement program for jack pine, black spruce and white spruce. On the West Coast, the Saanich Forestry Centre is focusing its efforts on the genetic improvement of hemlock and Douglas fir.

Canadian Pacific Forest Products is involved in community programs to increase public understanding of its forestry practices. For example, in British Columbia, the Corporation conducts public tours of its operations, has launched a classroom educational program, has constructed forest trails for the use of school groups and the general public, and involves its foresters in public speaking engagements on a regular basis. In September of 1989, the Corporation conducted a one-day tour of its woodlands operations near Dalhousie, New Brunswick to provide government and community officials with a firsthand view of the Corporation's forest management program, including harvesting and reforestation activities.

Canadian Pacific Forest Products is committed to the ongoing refinement of its harvesting and regeneration activities and is working to increase the public's understanding of the extent of the Corporation's forest management program.

A new forest in British Columbia, planted by the Corporation in 1970.

The environment continues to grow as an issue of public concern and as a corporate priority. It is a subject that touches every aspect of the Corporation's business.

In 1989, Canadian Pacific Forest Products commenced a $145-million capital projects program relating specifically to environmental matters, to be completed over a period of four years. Expenditures in 1990 will total $81 million.

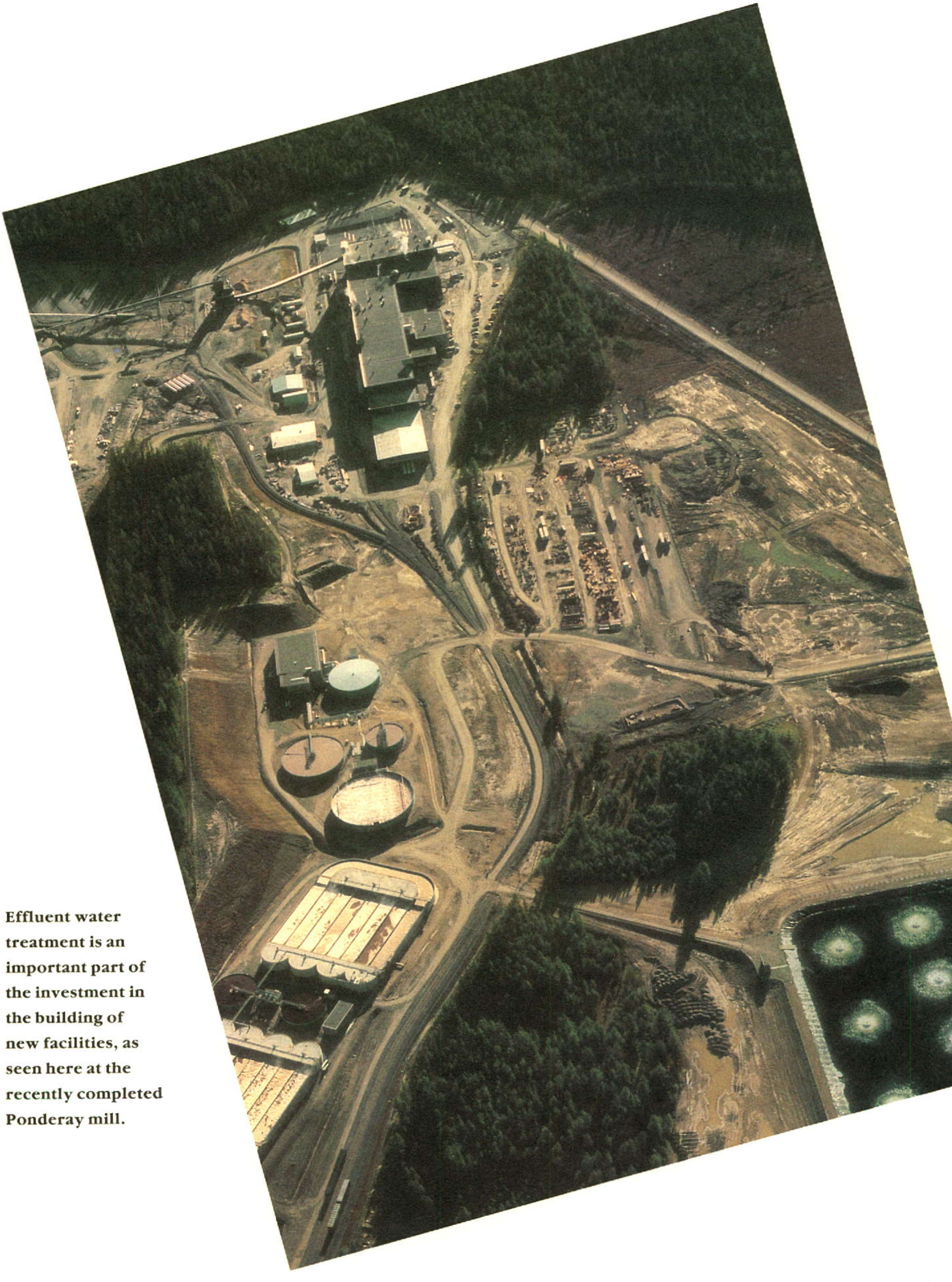
In early 1989, the Corporation's quick reaction in producing milk carton which resulted in milk not containing detectable levels of dioxins was well received by its dairy customers and the federal and provincial governments. Canadian Pacific Forest Products continues to monitor this important issue.

During 1990, the Corporation's bleached kraft pulp mills at Gold River, British Columbia and La Tuque, Quebec will convert their bleaching processes so that all of their pulp will be without detectable levels of dioxins. The pulp mill at Dryden, Ontario was successfully converted in 1988 and the mill at Thunder Bay, Ontario has never been found to produce pulp with detectable levels of dioxin.

Also in response to the dioxin issue, all of the Corporation's West Coast sawmills eliminated chlorophenols in 1989 from their lumber treatments. The Corporation's Eastern sawmills do not use chlorophenol-based treatments.

Other improvements within the Corporation's environmental program include the installation of a state-of-the-art, $36-million secondary effluent treatment system at the Thunder Bay kraft pulp mill which will significantly reduce biochemical oxygen demand (BOD), toxicity and chlorinated organics from the mill's outflow. Construction will begin in the spring of 1990 and will be completed in the fall of 1991.

Environmental considerations will remain a key factor in the planning and execution of the Corporation's major activities and will play an increasingly important role in its product marketing. The Corporation is committed to working closely with its customers in initiating changes which serve the evolving needs and demands of the population and market-place with respect to the environment.



Effluent water treatment is an important part of the investment in the building of new facilities, as seen here at the recently completed Ponderay mill.

Nineteen eighty-nine was a year of considerable success for the Corporation. However, by comparison with 1988, when most segments enjoyed relative strength to produce a record year, the weakening newsprint markets and strength of the Canadian dollar in 1989 resulted in a lower, but still substantial, level of earnings and cash flow.

OPERATIONS

1989 VS. 1988

Net earnings for 1989 at $220.1 million, or $5.01 per share, were down from $323.4 million, or $7.36 per share in 1988. Sales at $2.9 billion were down 4.3 percent in 1989 and cost of sales at $2 billion was up 3.7 percent. This compression of margins contributed to a reduction of operating earnings by 36 percent to $377.1 million, but lower interest expense and a slightly lower effective tax rate limited the reduction of net earnings to 32 percent.

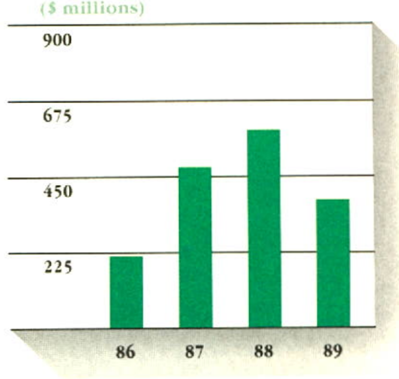
In 1989, more than half of the Corporation's sales were in U.S. dollars and the average exchange rate for the Canadian dollar increased from 81 cents U.S. to 85 cents U.S. This factor alone reduced sales by $79 million. The Canadian dollar also appreciated against other foreign currencies in which the Corporation sells.

Shipment volumes for all products, except white paper, were lower in 1989. Total tonnage of all pulp and paper products was down 3.9 percent to 2.9 million tonnes. The increased shipments of white paper resulted from the start-up of the second new machine at Dryden, Ontario rather than from a strengthening of the white paper market. Conversely, the reduction in shipments of pulp was the result of diverting approximately 30,000 tonnes of pulp to the production of additional white paper. The general weakening of the paper, paperboard and packaging products markets was felt most acutely in newsprint, where the principal cause was the significantly increasing North American capacity rather than seriously slackening demand. Newsprint list prices have not changed since the beginning of 1988, but discounting has become widespread, with the result that transaction prices in North America have decreased. The combined effect of the lower shipments, transaction prices and exchange reduced sales of the Corporation's newsprint segment by approximately $170 million in 1989. Pricing of bleached kraft pulp, on the other hand, increased by approximately 14 percent in 1989 so that, notwithstanding the lower shipments and exchange, sales for this segment increased by approximately $60 million.

Some pricing improvements for the Corporation's bleached board and tissue products and substantial increases in price for West Coast lumber to offshore markets accounted for most of the remaining areas of sales improvement.

Cost of sales at $2 billion increased by less than the rate of inflation but this was due mainly to the lower shipment volumes. Most of the business segments experienced increases in operating costs at approximately the rate of inflation. In addition, the kraft pulp and lumber operations on the West Coast incurred substantial increases in the cost of wood fibre, and the newsprint mill at Gatineau and the pulp mill at La Tuque had a number of mechanical difficulties that increased repair costs.

Interest payments increased by $9.4 million to $60.5 million in 1989 as the level of borrowing increased, but at lower average interest rates. However, the interest cost charged to earnings in 1989 decreased by $17.1 million since the amount capitalized to major projects under construction absorbed $37.1 million in 1989 compared with $10.6 million in 1988. The effective income tax rate was reduced by one percent in 1989 partly because of a change in allocation of earnings between provincial jurisdictions following the amalgamation of Great Lakes Forest Products Limited and CIP Inc. in 1988, and partly because of new tax legislation introduced in 1989.



Operating Earnings

1988 VS. 1987

The affairs of the Corporation for 1988 as they compared with those of 1987 were discussed in detail in the 1988 Annual Report made available to shareholders.

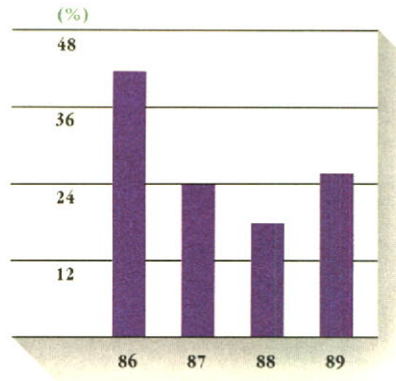
The principal matters discussed therein were that sales increased 8.7 percent in 1988 due primarily to higher selling prices of newsprint and market pulp and higher shipments of most pulp and paper products. Exchange had a negative impact as the Canadian dollar rose from an average of 75 cents U.S. in 1987 to 81 cents U.S. in 1988. Interest expense was lower in 1988 by approximately $45 million and the effective tax rate reduced by almost five percent. These factors increased net earnings in 1988 by 51 percent. The higher earnings and cash flow, despite capital spending of $278 million, enabled the reduction of total debt in 1988 by $210 million, resulting in a debt to equity ratio of 17:83 at the end of that year.

FINANCIAL CONDITION AND LIQUIDITY

Cash from operations was down $125.2 million in 1989 at $345.2 million. This was largely due to the decrease of $103.3 million in earnings, with some offset for the fact that a higher proportion of income taxes included therein were deferred. The other principal reasons for the reduced cash available from operations was a $91.5 million increase in non-cash working capital requirements. The most significant components of this increase resulted from the payment in 1989 of a large balance of 1988 income taxes along with 1989 taxes and an increase in inventories, principally wood. Positive contributions to the cash position were the lower balance of accounts receivable and higher balance of accounts payable at the end of 1989.

Capital spending in 1989 amounted to $480.4 million compared to $277.8 million in 1988. The major expenditures for the year were $46.1 million to complete the new white paper machine at Dryden, $36.1 million on the thermo-mechanical pulp mill and $84.2 million on the new newsprint machine at Thunder Bay, $17.5 million on the large log sawmill at Tahsis, and $17.4 million U.S. and $38.2 million of additional equity investment in the two joint venture newsprint projects at Ponderay and Gold River respectively. Dividend payments to the Corporation's common shareholders increased $37.5 million to $114.3 million in 1989, primarily due to the increased number of shares outstanding following the merger in June 1988 and the increase in dividend rate in 1988.

The lower cash flow from operations and the higher level of capital spending and dividend payout resulted in an increase



Ratio of Total Debt to Equity

in borrowings in 1989. This was accomplished by drawing on the Corporation's various line of credit facilities with banks and Canadian Pacific Securities Limited, an affiliated company. Late in the year, $125 million of these drawings were refinanced through the issue of 25-year, 10.85 percent unsecured debentures. These securities have been rated A (high) and A by the two principal Canadian bond rating agencies. This issue and these ratings have established for the Corporation access to the Canadian public financial markets.

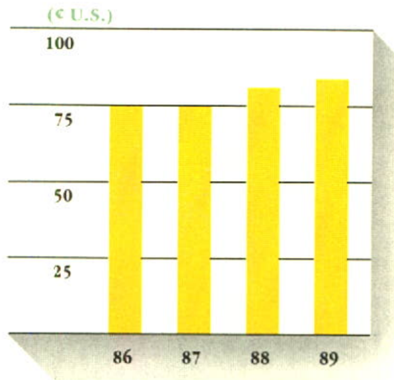
At the end of 1989, long-term debt amounted to $330 million and short-term debt, net of temporary deposits, was $249.3 million for a total of $579.3 million. This compared with a total of $328.3 million at the end of 1988. Approximately 50 percent of the Corporation's total debt at the end of 1989 was at fixed rates. As at December 31, 1989, the Corporation has unused, committed bank lines of credit of $552.8 million. The ratio of total debt to equity at the end of 1989 was 25:75, well within acceptable levels for the Corporation.

FUTURE EVENTS AND TRENDS

Generally, most of the Corporation's mills and facilities are new or have been modernized to meet the competitive and environmental standards currently required. Some of the Corporation's mills have reached an age where further process changes and technological advances could enhance plant efficiency, product quality, and environmental performance. Each of these mills is being studied to determine a course of action best suited to the resources available. The solutions will require substantial amounts of capital over the next ten years, but it is the intention to time them to fit the cash flow expectations and financial resources available to the Corporation. With respect to environmental requirements, the Corporation has embarked on a $145-million capital program over the period 1989 through 1992 to address detectable levels of toxic substances in bleached products and water quality of mill outflows.

In response to a growing public concern for municipal solid waste disposal, legislation and other pressures are emerging which require users of paper and paper products in the Corporation's principal North American market areas to purchase increasing percentages of their paper containing recycled fibre. The Corporation has long been a user of recycled carton stock at its corrugating medium mill in Matane and is increasingly a user of recycled paper stock at its tissue mill in Toronto. The Corporation has recently taken a leading role in the Canadian industry in announcing a $175-million program to install re-pulping and de-inking facilities for old newspapers and magazines at its two largest newsprint mills at Gatineau and Thunder Bay. When installed by mid-1991, they will enable the Corporation to produce recycled-content newsprint to serve this developing market.

The Corporation has capital commitments over the next three years for projects approved or underway totalling approximately $820 million. Principal among these are the modernization program underway at Thunder Bay, the environmental program, the de-inking facilities, minor completion work at its newsprint joint venture projects and a number of other projects of individually smaller scale. Over the period of these expenditures, the Corporation anticipates that it will be in a position to raise from outside sources the funds it requires, in excess of internally generated funds, to fulfill its obligations including its commitments with respect to working capital, capital expenditures,



Average Value of Canadian Dollar

repayment of loans and payment of dividends.

The current state of the newsprint market in North America could have a significant detrimental effect on the Corporation. Newsprint is the Corporation's largest business segment representing in 1989, 51 percent of shipments of pulp and paper products, 35 percent of sales and 42 percent of assets. At current transaction prices, the newsprint business has become marginal. However, the present depressed prices are mainly the result of substantial capacity increases which are coming on-line over the next two years rather than a general decrease in demand for newsprint. It is expected that operating rates will be in the low 90 percent range and prices will remain depressed over the next 12 to 18 months, following which, growth in demand will absorb the new capacity and normal profitability will begin to return. This cyclical pattern is not uncommon for the newsprint industry. Conversely, northern softwood bleached kraft pulp, the other major product of the

Corporation, representing in 1989, 31 percent of shipments of pulp and paper products, 30 percent of sales and 22 percent of assets, is expected to sustain most of its current market strength over the near term.

More than half of the Corporation's sales are made in U.S. dollars, and sales are also made in other foreign currencies. Consequently, exchange rate fluctuations have a significant impact on the Corporation's earnings. Each one U.S. cent annual change in the value of the Canadian dollar resulted in a change in net earnings of approximately $15 million.

The above risks and uncertainties are common to the Canadian forest products industry and are accepted by the Corporation as normal business risks which are allowed for within corporate development and financial planning.

Consolidated Financial Statements

Consolidated Statement of Earnings

Year ended December 31 (in millions of dollars, except per share amounts)	1989	1988
Sales	$2,876.4	$3,005.9
Cost of delivery	225.4	226.3
Net sales	2,651.0	2,779.6
Cost of sales	2,020.0	1,947.5
Depreciation and depletion	152.0	150.7
Selling and administrative expenses	97.9	94.0
Equity in losses of joint ventures (Note 4)	4.0	–
Operating earnings	377.1	587.4
Interest expense (Note 9)	23.4	40.5
Other income	11.3	7.6
Earnings before income taxes and minority interest	365.0	554.5
Income taxes (Note 10)	141.7	220.9
Earnings before minority interest	223.3	333.6
Minority interest	3.2	10.2
Net earnings	$ 220.1	$ 323.4
Net earnings per share (Note 1)	$ 5.01	$ 7.36

Consolidated Statement of Retained Earnings

Year ended December 31 (in millions of dollars)	1989	1988
Balance at beginning of year	$695.0	$472.4
Merger costs	–	(4.2)
Net earnings	220.1	323.4
Dividends declared	(114.3)	(96.6)
Balance at end of year	$800.8	$695.0

December 31 (in millions of dollars)	1989	1988
ASSETS		
Current assets		
Deposits with an affiliate	$ 0.2	$ 5.4
Accounts receivable	355.6	392.5
Inventories (Note 2)	415.4	401.4
Prepaid expenses	9.1	9.9
	780.3	809.2
Fixed assets (Note 3)		
Plants and properties	3,288.5	2,899.8
Timberlands	152.5	152.5
Less: Accumulated depreciation and depletion	1,286.5	1,154.1
	2,154.5	1,898.2
Other assets		
Investment in joint ventures (Note 4)	117.1	55.3
Deferred items	19.4	11.7
	136.5	67.0
	$3,071.3	$2,774.4

December 31 (in millions of dollars)	1989	1988
LIABILITIES		
Current liabilities		
Bank indebtedness	$ 25.0	$ 31.7
Accounts payable and accrued charges	240.8	237.8
Loans from an affiliate	189.1	91.9
Income and other taxes payable	6.5	126.5
Dividend payable	28.6	28.6
Current portion of long-term debt	35.4	95.4
	525.4	611.9
Long-term debt, less current portion (Note 5)	330.0	114.7
Deferred income taxes	462.1	396.1
Other liabilities	10.6	13.7
Minority interest	52.5	53.1
	1,380.6	1,189.5
Shareholders' equity		
Common shares (Note 7)	376.0	376.0
Paid-in surplus	513.9	513.9
Retained earnings	800.8	695.0
	1,690.7	1,584.9
	$3,071.3	$2,774.4

Approved by the Board,

Cecil S. Flenniken

Cecil S. Flenniken, Director

Michel Bélanger

Michel Bélanger, Director

Consolidated Statement of Changes in Cash Position

Year ended December 31 (in millions of dollars)	1989	1988
CASH PROVIDED (USED)		
Operating activities		
Net earnings	$ 220.1	$ 323.4
Items not involving cash		
Depreciation and depletion	152.0	150.7
Deferred income taxes	66.0	36.4
Minority interest	3.2	10.2
Equity in losses of joint ventures	4.0	–
Other	(8.6)	(20.5)
	436.7	500.2
Change in non-cash working capital relating to operations	(91.5)	(29.8)
Cash from operations	345.2	470.4
Financing activities		
Increase (decrease) in long-term debt	159.0	(310.6)
Redemption of preferred shares of subsidiaries	(2.6)	(3.9)
Other	(1.4)	–
	155.0	(314.5)
Investing activities		
Additions to plants and properties	(409.9)	(237.2)
Investment in joint ventures	(66.7)	(48.1)
Other	(3.8)	7.5
	(480.4)	(277.8)
Other activities		
Dividends paid to common shareholders	(114.3)	(76.8)
Dividends paid to minority interest	(1.2)	(1.7)
Merger costs	–	(4.2)
	(115.5)	(82.7)
Decrease in cash position	(95.7)	(204.6)
Cash (indebtedness) at beginning of year	(118.2)	86.4
Cash (indebtedness) at end of year	$(213.9)	$(118.2)
Cash (indebtedness) consists of		
Deposits with an affiliate	$ 0.2	$ 5.4
Bank indebtedness	(25.0)	(31.7)
Loans from an affiliate	(189.1)	(91.9)
	$(213.9)	$(118.2)

December 31, 1989

1. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Corporation and all domestic and foreign subsidiary companies. All significant intercompany transactions and balances have been eliminated.

The merger of Great Lakes Forest Products Limited and CIP Inc. on June 2, 1988 to create Canadian Pacific Forest Products Limited was accounted for using the pooling of interests method and the earnings, earnings per share and changes in cash position for 1988 are reported as though the merger had taken place on January 1, 1988.

The Corporation follows the equity method of accounting for its investment in joint ventures.

Foreign exchange

Monetary assets and liabilities are translated from foreign currencies into Canadian dollars at rates of exchange at the date of the balance sheet. The unrealized translation gains or losses on foreign currency denominated long-term debt are amortized over the remaining life of the debt. Non-monetary assets and liabilities are translated at historical rates.

Revenues and expenses (except depreciation, depletion and amortization, which are translated at historical rates) are translated at average rates in effect during the month in which the transaction took place.

Inventories

Inventories of finished products are valued at the lower of average cost and net realizable value. Inventories of pulpwood, sawlogs, materials and supplies are valued at average cost.

Plants and properties

Plants and properties are stated at cost which is after the deduction of investment tax credits. The Corporation depreciates its plants and properties over their estimated useful lives using the unit of production method for its pulp and paper mills and the straight-line method for other plants and properties. The pulp and paper mills, which are the Corporation's principal fixed assets, are depreciated over a period of approximately 22 years.

Interest is capitalized on major expansion projects and on the Corporation's investment in joint ventures during the construction period.

No depreciation is charged on major improvements or expansions until construction is completed. Start-up costs incurred by newly constructed facilities are deferred until normal operation is achieved and amortized over a period of five years.

Income taxes

Deferred income taxes are provided for all significant timing differences between the recognition of income and expenses for financial statement and tax purposes.

2. INVENTORIES

(in millions of dollars)	1989	1988
Raw materials	$224.5	$210.2
Repair materials and other operating supplies	118.2	110.6
Finished products	72.7	80.6
	$415.4	$401.4

3. Fixed Assets

Plants and properties

(in millions of dollars)

	1989			1988
	Cost	Accumulated Depreciation	Net	Net
Land	$ 59.8	$ –	$ 59.8	$ 60.0
Buildings and equipment	3,228.7	1,254.1	1,974.6	1,716.0
	$3,288.5	$1,254.1	$2,034.4	$1,776.0

Timberlands

(in millions of dollars)

	1989				1988
	Square Kilometers	Cost	Accumulated Depletion	Net	Net
Owned in fee	6,949	$139.2	$22.0	$117.2	$118.9
Held under government licence	95,698	13.3	10.4	2.9	3.3
	102,647	$152.5	$32.4	$120.1	$122.2

The Corporation has timber harvesting licensing arrangements in the provinces of British Columbia, New Brunswick and Ontario, plus harvesting rights measured in wood volume in the provinces of Quebec and British Columbia. The Corporation has reforestation obligations which are associated with its harvesting activities. The costs of reforestation are included in the operating cost of wood harvested.

The amount of cutting rights in the Province of Quebec may vary depending on the implementation of new legislation which became effective on April 1, 1987 and which provides for negotiations during the period 1988-1990 for replacement of former timber harvesting licensing arrangements.

4. Investment in Joint Ventures

The Corporation has two principal investments in joint venture partnerships:

Ponderay Newsprint Company

A general partnership was formed to construct and operate a newsprint mill in the northeastern part of Washington State. The mill started up in November 1989 and began producing and shipping quality newsprint to its publisher partners and others in early December 1989.

The Corporation's 40% interest in the partnership and its commitment as managing partner and general contractor responsible for construction of the mill are being undertaken through two wholly-owned subsidiaries whose performances the Corporation has guaranteed. As at December 31, 1989, the Corporation has invested $32.2 million U.S. as its equity in the partnership and has guaranteed its 40% share, $114 million U.S., of a project finance loan to a syndicate of banks, which loan has been fully drawn down. Following certain performance criteria, which it is expected the mill will achieve, the Corporation's loan guarantee will reduce to $50 million U.S.

The Corporation, in accordance with the partnership agreements, has a commitment to fund an additional $11.8 million U.S. in equity over the next two years.

Through its subsidiary as general contractor, the Corporation has agreed to bear the full cost of a construction overrun to the extent the overrun exceeds a specified amount substantially in excess of the estimated final capital cost of the project. Since the mill is now running, it is not expected such an overrun will occur and, under the terms of the construction contract, if the mill demonstrates its ability to sustain certain performance criteria, the Corporation, through its subsidiary, will become entitled to construction fees approximating $20 million U.S.

Gold River Newsprint Limited Partnership

A limited partnership was formed to construct and operate a newsprint mill on the west coast of Vancouver Island in British Columbia. The mill started up in November 1989 and began producing and shipping quality newsprint to its publisher partners and others in January 1990.

The Corporation has a 60.5% interest in the limited partnership and is the general partner. As at December 31, 1989, the Corporation has invested $78 million as its equity in the partnership. As general partner, the Corporation is liable for the amount drawn under a project finance loan from a syndicate of banks. The mill is now operating, and following certain performance criteria, which are expected to be achieved, all of the loan will be without recourse to the Corporation. As at December 31, 1989, $203.9 million was drawn under the loan facility.

The Corporation's share of the combined assets and liabilities and revenues and expenses of joint ventures for the years ended December 31, 1989 and 1988 are as follows:

(in millions of dollars)	1989	1988
Current assets	$ 12.4	$ 6.9
Fixed assets	372.4	217.6
Other assets	27.0	2.8
	$411.8	$227.3
Current liabilities	$ 34.4	$ 23.9
Other liabilities	6.4	2.9
Long-term debt	253.9	145.2
Partners' capital	117.1	55.3
	$411.8	$227.3
Sales	$ 10.5	$ –
Costs and expenses	12.0	–
Depreciation	1.0	–
Interest	1.5	–
	14.5	–
Equity in losses of joint ventures	$ (4.0)	$ –

5. Long-term Debt

(in millions of dollars)	1989	1988
10.85% Debentures due 2014	$125.0	$ –
Bank term loans at floating rates maturing from 1991 to 1997	183.6	60.6
11.94% Term loan due 1990	29.0	29.8
Loans from an affiliated company		
15.2% Loan due 1989	–	89.4
8.3% Debenture maturing 1990 – 1993	1.8	2.0
Other long-term obligations maturing at various dates	26.0	28.3
	365.4	210.1
Less: Current portion	35.4	95.4
	$330.0	$114.7

At December 31, 1989, $87.4 million of the Corporation's long-term debt was denominated in U.S. dollars ($179.8 million in 1988).

All of the Corporation's long-term debt is unsecured.

As at December 31, 1989, the Corporation has available unused long-term bank lines of credit of $552.8 million.

Payments required on long-term debt over the next five years are as follows (in millions of dollars):

1990	–	$35.4
1991	–	$15.6
1992	–	$18.7
1993	–	$18.7
1994	–	$18.9

6. Commitments

At December 31, 1989, excluding the amounts to be invested in a joint venture referred to in Note 4, the Corporation has commitments for major capital expenditures under purchase orders and contracts amounting to approximately $121 million.

7. Share Capital

As at December 31, 1989, the Corporation's authorized common share capital is an unlimited number of shares of which 43,959,195 have been issued. The Corporation has a stock option plan for key employees. The number of shares that may be issued under the plan is limited to 800,000. As at December 31, 1989, options to purchase 133,667 shares at prices approximating $41 have been granted. No options have been exercised.

8. Pensions

The Corporation's pension plans are principally defined benefit pension plans and cover substantially all employees. Benefits from these plans are based on years of service and either career earnings or final average earnings.

The pension costs are determined annually in consultation with independent actuaries and include current service costs and a provision for the amortization of prior service costs. Pension costs for current services are charged to earnings in the year incurred. The liability for past service is charged to earnings over the estimated remaining service lives of the employees.

The date of the most recent actuarial valuation for the defined benefit pension plans is December 31, 1988. Pension expenses and actuarial estimates of the financial position of the plans are itemized below:

(in millions of dollars)	1989	1988
Pension expense	$ 17.3	$ 12.8
Pension fund assets at market related values	$708.4	$675.0
Present value of accrued pension benefits obligation	$719.6	$690.0
Deficit	$ 11.2	$ 15.0

9. Interest

Interest on long-term debt amounted to $39.4 million in 1989 and on short-term indebtedness to $21.1 million (1988 – $47.2 million and $3.9 million respectively). Of these amounts, $37.1 million in 1989 has been capitalized with respect to major projects under construction (1988 – $10.6 million).

10. Reconciliation of Income Tax Rates

(in millions of dollars)	1989		1988	
	Tax rate	Amount	Tax rate	Amount
Earnings before income taxes and minority interest		$365.0		$554.5
Income taxes using combined statutory federal and provincial rates	39.8%	145.3	43.4%	240.9
Manufacturing and processing deduction	(2.2)	(8.0)	(4.0)	(22.2)
Large corporations tax	0.7	2.5	–	–
Non-deductible expenses and other items	0.5	1.9	0.4	2.2
Income taxes		$141.7		$220.9
Effective tax rate	38.8%		39.8%	

11. Related Party Transactions

Canadian Pacific Enterprises Limited owns approximately 79.7% of the common shares of the Corporation, and consequently, the many companies within the Canadian Pacific organization are affiliates. The Corporation purchases from these affiliated companies transportation services and manufactured products at competitive prices. For 1989, these purchases amounted to $97.6 million (1988 – $98.2 million). Interest costs on borrowings from an affiliate during the year were $29.0 million (1988 – $30.4 million).

The Corporation receives fees for the marketing of newsprint and management of its two joint venture partnerships, Ponderay Newsprint Company and Gold River Newsprint Limited Partnership. It also recovers costs incurred directly for these partnerships. These fees and recoveries amounted to $13.6 million in 1989 (1988 – $6.9 million). The Corporation supplies all of the wood chips and kraft pulp required by the Gold River Newsprint Limited Partnership and may occasionally supply kraft pulp to Ponderay Newsprint Company. All such supplies are sold to the partnerships at market prices and in 1989 amounted to $8.6 million.

12. Segmented Information

Geographic areas

All of the Corporation's manufacturing facilities consolidated within the financial statements are located in Canada. The Corporation's joint venture interest in Ponderay Newsprint Company described in Note 4 is located in the United States.

In 1989, the Corporation had export sales of $1,345 million to the United States (1988 – $1,407 million) and of $676 million to other countries (1988 – $698 million).

Industry segments

The Corporation's operations and assets by industry segment are as follows:

(in millions of dollars)

1989 Business Segment		Sales to Significant Geographic Segment	Sales to Customers	Inter-Segment Sales	Segment Sales	Depreciation & Depletion	Operating Earnings	Additions to Fixed Assets	Total Assets
Newsprint	U.S.A.	71%	$1,017.5	$ –	$1,017.5	$ 47.5	$ 18.1	$199.1	$1,305.5
Pulp	U.S.A.	56%	849.2	75.5	924.7	36.5	323.0	47.3	673.2
Paperboard and packaging	Canada	88%	348.0	180.8	528.8	16.1	30.5	24.2	314.9
White paper	Canada	67%	149.0	–	149.0	10.2	7.2	63.7	323.4
Tissue products	Canada	88%	177.7	–	177.7	5.6	13.2	6.4	103.3
Lumber and other wood products	Canada	36%	258.0	153.0	411.0	29.6	(12.8)	55.8	310.0
Other			77.0	–	77.0	6.5	(2.1)	2.2	29.0
Eliminations			–	(409.3)	(409.3)	–	–	–	–
Corporate			–	–	–	–	–	11.2	12.0
Total			$2,876.4	$ –	$2,876.4	$152.0	$377.1	$409.9	$3,071.3

1988 Business Segment		Sales to Significant Geographic Segment	Sales to Customers	Inter-Segment Sales	Segment Sales	Depreciation & Depletion	Operating Earnings	Additions to Fixed Assets	Total Assets
Newsprint	U.S.A.	70%	$1,189.8	$ –	$1,189.8	$ 47.5	$204.1	$ 33.6	$1,090.6
Pulp	U.S.A.	58%	790.9	75.9	866.8	38.9	279.4	28.7	690.6
Paperboard and packaging	Canada	86%	387.0	185.5	572.5	16.2	57.4	13.9	274.0
White paper	Canada	79%	115.6	–	115.6	6.5	13.6	121.2	268.5
Tissue products	Canada	86%	167.9	–	167.9	5.4	12.6	4.0	100.6
Lumber and other wood products	Canada	40%	280.6	165.4	446.0	29.7	16.5	34.8	308.1
Other			74.1	–	74.1	6.5	3.8	1.0	36.6
Eliminations			–	(426.8)	(426.8)	–	–	–	–
Corporate			–	–	–	–	–	–	5.4
Total			$3,005.9	$ –	$3,005.9	$150.7	$587.4	$237.2	$2,774.4

Management Report

The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles. The financial information contained elsewhere in the annual report is consistent with the consolidated financial statements.

Management maintains a system of internal accounting and administrative controls designed to provide reasonable assurance that the financial information is accurate and reliable and that the Corporation's assets are adequately accounted for and safeguarded. These controls are reviewed regularly by the internal audit department and their findings are presented to management and the Audit Committee.

The Audit Committee, which is comprised of outside directors, meets with management, the internal auditors and Price Waterhouse, the independent auditors, to review the adequacy of the system of internal controls and the integrity of the Corporation's financial reporting.

The consolidated financial statements have been reviewed by the Audit Committee prior to submission to the Board. In addition, the consolidated financial statements have been examined by Price Waterhouse whose report is provided below.

CECIL S. FLENNIKEN
Chairman and Chief Executive Officer

PAUL E. GAGNÉ
President and Chief Operating Officer

Auditors' Report

To the Shareholders of
Canadian Pacific Forest Products Limited

We have examined the consolidated balance sheets of Canadian Pacific Forest Products Limited as at December 31, 1989 and 1988 and the consolidated statements of earnings, retained earnings and changes in cash position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1989 and 1988 and the results of its operations and the changes in its cash position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Montreal, Quebec
January 30, 1990

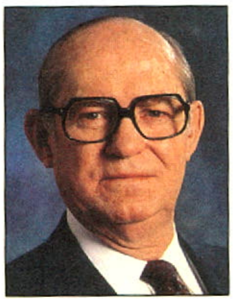
PRICE WATERHOUSE
Chartered Accountants

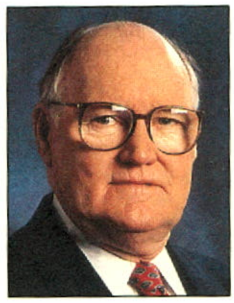
(in millions of dollars, except per share amounts)	Sales	Operating Earnings	Net Earnings	Net Earnings Per Share	Dividends Declared Per Share	Price Range Per Share on The Toronto Stock Exchange	
1989						High	Low
First Quarter	$ 711.0	$111.4	$ 65.1	$1.48	$0.65	$49½	$41½
Second Quarter	741.8	117.2	72.9	1.66	0.65	45½	42
Third Quarter	707.6	84.9	45.1	1.03	0.65	44	40½
Fourth Quarter	716.0	63.6	37.0	0.84	0.65	42	35¾
	$2,876.4	$377.1	$220.1	$5.01	$2.60		
1988							
First Quarter	$ 736.2	$143.8	$ 74.3	$1.69	$0.55	$50	$42
Second Quarter	753.5	140.4	74.3	1.69	0.65	54½	43
Third Quarter	766.6	159.5	92.6	2.11	0.65	48¾	39½
Fourth Quarter	749.6	143.7	82.2	1.87	0.65	43½	39½
	$3,005.9	$587.4	$323.4	$7.36	$2.50		

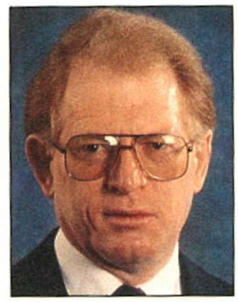
Note: Data on dividends per share and price range per share for the first quarter of 1988 are for Great Lakes Forest Products Limited.

	1989	1988	1987	1986
(in millions of dollars)				
Operations				
Sales	$2,876.4	$3,005.9	$2,764.7	$2,316.7
Operating earnings	377.1	587.4	476.6	215.6
Interest expense	23.4	40.5	85.4	128.8
Income taxes	141.7	220.9	179.1	49.0
Earnings before extraordinary items	220.1	323.4	214.0	31.6
Extraordinary items	–	–	–	1.7
Net earnings	220.1	323.4	214.0	33.3
Cash from operations	345.2	470.4	511.0	229.0
Dividends declared	114.3	96.6	28.3	7.8
(in dollars)				
Per share				
Earnings before extraordinary items	$5.01	$7.36	$4.87	$1.04
Net earnings	5.01	7.36	4.87	1.08
Dividends declared	2.60	2.50	1.45	0.40
(in millions of dollars, except per share amounts)				
Other data				
Investing activities	$ 480.4	$ 277.8	$ 171.1	$ 170.4
Assets	3,071.3	2,774.4	2,669.4	2,542.7
Shareholders' equity	1,690.7	1,584.9	1,362.3	1,154.6
Ratio of total debt to equity	25:75	17:83	24:76	41:59
Return on shareholders' equity	13.4%	21.9%	17.0%	3.3%
Price range per share				
The Toronto Stock Exchange				
High	49½	54½	56⅛	33¾
Low	35¾	39½	32	17⅞
Average number of employees	14,981	15,224	15,921	15,861

	1989	1988	1987	1986
(in thousands of tonnes)				
Shipments				
Newsprint	1,492	1,560	1,522	1,411
Pulp	899	933	912	868
Paperboard and packaging	352	396	404	411
White paper	131	101	101	100
Tissue products	71	75	68	71
Lumber (million board feet)	428	484	490	389
(in millions of dollars)				
Sales				
Newsprint	$1,017.5	$1,189.8	$1,085.5	$953.7
Pulp	849.2	790.9	676.3	515.7
Paperboard and packaging	348.0	387.0	375.2	359.1
White paper	149.0	115.6	105.6	100.3
Tissue products	177.7	167.9	148.0	146.6
Lumber and other wood products	258.0	280.6	300.2	175.3
(in millions of dollars)				
Operating earnings				
Newsprint	$ 18.1	$ 204.1	$ 155.4	$111.7
Pulp	323.0	279.4	195.8	37.2
Paperboard and packaging	30.5	57.4	43.4	31.0
White paper	7.2	13.6	7.7	7.8
Tissue products	13.2	12.6	11.9	16.8
Lumber and other wood products	(12.8)	16.5	58.6	5.3

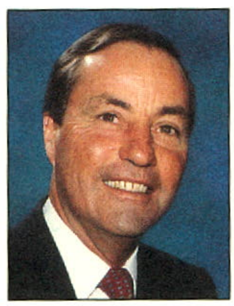

Cecil S. Flenniken
Chairman and Chief Executive Officer
Canadian Pacific Forest Products Limited


F. D'Arcy Quinn
Vice-Chairman
Canadian Pacific Forest Products Limited

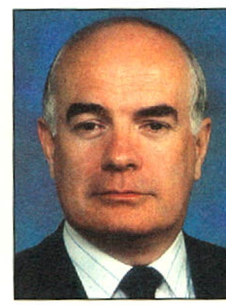

***Paul E. Gagné**
President and Chief Operating Officer
Canadian Pacific Forest Products Limited

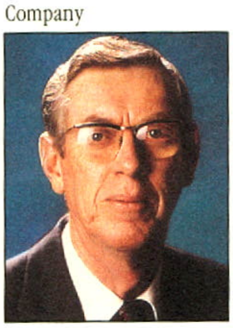

Harold W. Andersen
Director and Contributing Editor
Omaha World-Herald Company


Michel Bélanger
Chairman of the Board
National Bank of Canada

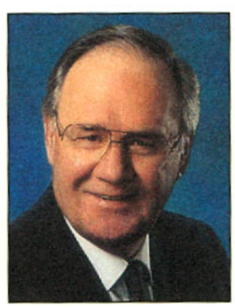

Hon. William R. Bennett, P.C.
Corporate Director

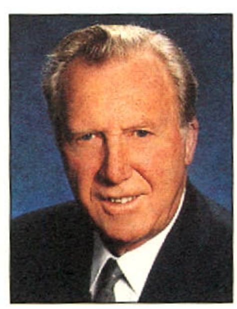

Robert W. Campbell
Director
Canadian Pacific Limited


James F. Hankinson
Executive Vice-President
Canadian Pacific Limited

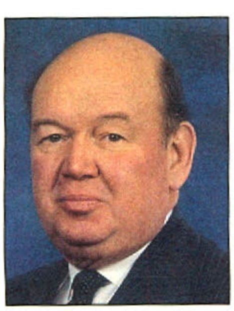

W. Norman Kissick
Chairman and Chief Executive Officer
Union Carbide Canada Limited


J. Ross LeMesurier
Corporate Director


E. Neil McKelvey, Q.C.
Partner
McKelvey, Macaulay, Machum

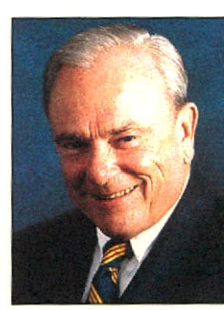

Richard C. Meech, Q.C.
Partner
Borden & Elliot


Paul Paré
Corporate Director


Claude Pratte, Q.C.
Counsel
Stein, Monast, Pratte & Marseille


Stanley H. Stauffer
Chairman of the Board
Stauffer Communications, Inc.


William W. Stinson
Chairman, President and Chief Executive Officer
Canadian Pacific Limited


John G. Trezevant
Consultant
Creators Syndicate

*Elected to the Board of Directors on February 2, 1990.

Committees of the Board

Executive Committee
M. Bélanger
C.S. Flenniken (Chairman)
J.F. Hankinson
R.C. Meech, Q.C.
P. Paré
F.D. Quinn
W.W. Stinson

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M. Bélanger (Chairman)
J.R. LeMesurier
E.N. McKelvey, Q.C.
R.C. Meech, Q.C.
C. Pratte, Q.C.

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W.N. Kissick
J.R. LeMesurier
P. Paré (Chairman)

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Hon. W.R. Bennett, P.C.
J.F. Hankinson
C. Pratte, Q.C. (Chairman)
W.W. Stinson

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Chairman and Chief Executive Officer

F. D'Arcy Quinn
Vice-Chairman

***Paul E. Gagné**
President and Chief Operating Officer

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Executive Vice-President, and President, Great Lakes and Tahsis Pacific Regions

J. Hugh Whalen
Executive Vice-President, Marketing

***David G. Toole**
Senior Vice-President, Finance, Accounting and Logistics

***Wayne B. Wolfe**
Senior Vice-President, Manufacturing and Woodlands Operations

***Donald A. Bridges**
Vice-President, Converting

Gaudry Delisle
Vice-President, Management Information Systems

Sandy M. Fulton
Vice-President, and Executive Vice-President, Tahsis Pacific Region

Norman W. Lord
Vice-President, Overseas Sales

William H. Martin
Vice-President, Corporate Affairs

Marc Régnier
Vice-President, Administration and General Counsel

Keith E. Winrow
Vice-President and Comptroller

Warren P. Woodworth
Vice-President, Newsprint Sales – North America

Denis Aubin
Treasurer

Jacques Beauchamp
Secretary

Serge Bureau
Internal Auditor

Anthony Iasenza
Senior Assistant-Comptroller and Assistant-Treasurer

Maxim Broady
Assistant-Comptroller

Gregory St-Laurent
Assistant-Treasurer

Sheila Britt MacKenzie
Assistant-Secretary

*as of February 2, 1990.

Annual Meeting
The annual meeting of shareholders of Canadian Pacific Forest Products Limited will be held on Tuesday, April 17, 1990 at 11:30 a.m. at the Royal York Hotel, 100 Front Street West, Toronto, Ontario, Canada.

Transfer Agents and Registrars
Montreal Trust Company, Vancouver, Calgary, Regina, Winnipeg, Toronto, Montreal and Halifax, Canada.
Bank of Montreal Trust Company, New York, United States.

Stock Exchanges
Common shares are listed on the Toronto and Montreal stock exchanges. The stock market symbol is PFP.

Currency
All amounts stated in this report are in Canadian dollars, unless otherwise specified.

Measurements
One tonne or metric ton equals 1,000 kilograms or 2,204.6 pounds.
One hectare is equivalent to 2.471 acres.

Pour obtenir la version française du présent rapport, veuillez faire la demande par écrit au secrétaire:
Produits Forestiers Canadien Pacifique Limitée
1155, rue Metcalfe
Montréal (Québec) Canada
H3B 2X1

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Legal Deposit
1st Quarter 1990

Printed in Canada

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