FraserPapers

FRASER PAPERS INC.

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2008

Management's Responsibility for the Financial Statements

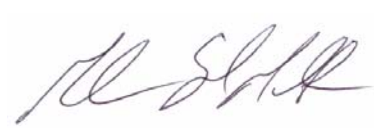
The accompanying consolidated financial statements and other financial information have been prepared by the Company's management, which is responsible for their integrity and objectivity, in accordance with Canadian generally accepted accounting principles. Financial statements are not precise since they include certain amounts based upon estimates and judgements. When alternative methods exist, management has chosen those it deems to be the most appropriate in the circumstances. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

Management is responsible for establishing and maintaining adequate internal controls. Fraser Papers maintains internal controls systems which are designed to permit the accurate and timely preparation of financial statements in accordance with Canadian generally accepted accounting principles.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee is appointed by the Board and reviews the consolidated financial statements and management's discussion and analysis; considers the report of the external auditors; assesses the adequacy of the internal controls of the Company; examines the fees and expenses for audit services; and recommends to the Board the independent auditors for appointment by the shareholders. The Committee reports its findings to the Board of Directors for consideration when approving the consolidated financial statements for issuance to the shareholders.

Peter Gordon
Chief Executive Officer



Glen McMillan
Senior Vice President and Chief Financial Officer

February 4, 2009

AUDITORS' REPORT

To the Shareholders of
Fraser Papers Inc.

We have audited the consolidated balance sheets of **Fraser Papers Inc.** (the "Company") as at December 31, 2008 and 2007 and the consolidated statements of operations, deficit, comprehensive loss and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Toronto, Canada
February 4, 2009

Consolidated Balance Sheets

As at December 31	2008	2007
(US$millions)		*(restated – note 2)*
Assets		
Current assets:		
Accounts receivable	**$ 67.9**	$ 99.1
Inventory *(note 3)*	**125.5**	124.2
Future income taxes *(note 9)*	**0.3**	0.2
	193.7	223.5
Property, plant and equipment *(note 4)*	**256.0**	266.2
Other assets *(note 5)*	**60.9**	56.5
	$ 510.6	$ 546.2
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness	**$ 7.4**	$ 4.3
Accounts payable and accrued liabilities	**78.0**	106.4
Current debt *(note 6)*	**25.0**	81.6
	110.4	192.3
Long-term debt *(note 6)*	**64.0**	–
Other liabilities *(note 7)*	**48.4**	56.1
Future income taxes *(note 9)*	**3.5**	4.9
Shareholders' equity *(note 10)*	**284.3**	292.9
	$ 510.6	$ 546.2

(See accompanying notes)

On behalf of the Board:

Paul E. Gagné, CA
Audit Committee Chair

J. Peter Gordon
Chief Executive Officer

Consolidated Statements of Operations and Deficit

Years ended December 31 (US$millions, except per share amounts)	**2008**	2007 *(restated – note 2)*
Net sales	**$ 688.6**	$ 714.7
Cost of goods sold	**700.0**	739.5
Selling, general and administration costs	**22.2**	17.1
Loss before the following:	**(33.6)**	(41.9)
Gain on sale of equity investee *(note 16)*	**–**	38.4
Restructuring charges *(note 17)*	**–**	(15.9)
Other	**–**	0.8
Interest income	**0.5**	0.5
Interest expense	**(4.1)**	(7.3)
Loss before depreciation and income taxes	**(37.2)**	(25.4)
Depreciation	**(34.8)**	(31.1)
Income tax recovery *(note 9)*	**0.1**	13.4
Loss	**$ (71.9)**	$ (43.1)
Loss per share - basic and diluted *(note 10)*	**$ (1.48)**	$ (1.47)
Deficit		
Balance, beginning of year	**$ (203.0)**	$ (162.0)
Change in accounting policy *(note 2)*	**–**	2.1
Loss	**(71.9)**	(43.1)
Balance, end of year	**$ (274.9)**	$ (203.0)

(See accompanying notes)

Consolidated Statement of Comprehensive Loss and Accumulated Other Comprehensive Income

Years ended December 31 (US$millions)	**2008**	**2007** *(restated – note 2)*
Loss:	**$ (71.9)**	$ (43.1)
Changes in unrealized net gains on cash flow hedges	**3.0**	0.6
Changes in unrealized net gains on lumber hedges	**0.7**	–
Tax impact	**(1.3)**	(0.2)
Other comprehensive income	**2.4**	0.4
Comprehensive loss	**$ (69.5)**	$ (42.7)
Accumulated other comprehensive income		
Balance, beginning of year	**$ 0.2**	$ (0.2)
Other comprehensive income for the year	**2.4**	0.4
Balance, end of year	**$ 2.6**	$ 0.2

(See accompanying notes)

Consolidated Statements of Cash Flows

Years ended December 31 (US$millions)	2008	2007 (restated – note 2)
Cash provided by (used for):		
Operating Activities		
Loss	**$ (71.9)**	$ (43.1)
Items not affecting cash:		
Depreciation	**34.8**	31.1
Future income taxes *(note 9)*	**(0.5)**	(14.8)
Gain on sale of equity investee *(note 16)*	–	(38.4)
Restructuring charges *(note 17)*	–	15.9
Employment benefit plan expense *(note 8)*	**15.2**	13.5
Other	**(7.1)**	1.6
Employment benefit plan funding *(note 8)*	**(26.0)**	(31.2)
	(55.5)	(65.4)
Net change in non-cash working capital balances *(note 11)*	**9.6**	17.2
	(45.9)	(48.2)
Investing Activities		
Capital investments	**(27.1)**	(20.3)
Proceeds on sale of equity investee *(note 16)*	–	38.4
	(27.1)	18.1
Financing Activities		
Proceeds from rights offering *(note 6)*	**59.7**	–
Repayment of long-term debt *(note 6)*	**(50.0)**	(68.5)
Borrowings under term loan facility *(note 6)*	**18.6**	–
Borrowings under term credit facility *(note 6)*	**25.0**	–
Net borrowings under revolving credit facility *(note 6)*	**16.6**	81.6
	69.9	13.1
Decrease in cash and cash equivalents	**$ (3.1)**	$ (17.0)

(See accompanying notes)

Notes to the Consolidated Financial Statements

(US$millions, unless otherwise noted)

In these notes "Fraser Papers" means Fraser Papers Inc. and all of its consolidated subsidiaries and affiliates and "Company" means Fraser Papers Inc. as a separate corporation. "Norbord" means Norbord Inc. (a related party by virtue of a common controlling shareholder) or any of its consolidated subsidiaries. "Acadian" means Acadian Timber Income Fund (a related party by virtue of a common significant shareholder). "Brookfield" means Brookfield Asset Management Inc. (a related party by virtue of a controlling equity interest in the Company) or any of its consolidated subsidiaries.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the significant accounting policies listed below.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses during the period. Significant estimates include the determination of the carrying value and useful lives of property, plant and equipment, provisions for employee future benefits and future income tax assets and liabilities. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash in the bank and short-term deposits with a term to maturity of less than ninety days at the date of purchase. Cash and cash equivalents are recorded at fair value.

Valuation of Inventories

Inventories of raw materials and operating supplies are valued at the lower of average cost and replacement cost or net realizable value. Inventories of manufactured products are valued at the lower of average cost, which include all direct production costs and an allocation of overhead costs incurred at production facilities, or net realizable value.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and are depreciated on a straight-line basis. The rates of depreciation are intended to fully depreciate manufacturing and non-manufacturing assets over the following periods which approximate their useful lives:

Buildings	20 to 40 years
Lumbermills and lumber production equipment	10 to 15 years
Paper and pulp mill machinery and production equipment	20 years
Logging machinery and equipment	4 to 10 years

Interest costs directly related to major capital projects are capitalized during construction. Costs, net of revenues, incurred during the start-up period of major capital projects are deferred as other assets and amortized over the first three years of the life of the project. As at December 31, 2008 and 2007 there were no deferred start-up costs recorded in property, plant and equipment.

Impairment of Long-Lived Assets
The carrying value of long-lived assets, such as property, plant and equipment, are reviewed when events or circumstances change indicating that their carrying value may not be recoverable. Where such changes in events or circumstances indicate the carrying amounts may not be recoverable, the carrying value of those assets is compared to the estimated undiscounted future cash flows generated by their use. Where the carrying value of such assets does not exceed the estimated undiscounted future cash flows, these assets are recorded at fair value. The cash flow projections take into account the relevant operating plans and management’s best estimate of the most probable set of economic conditions anticipated to prevail in the market.

The Company’s estimate of future cash flows is subject to risks and uncertainties. It is possible that changes may occur which could affect the carrying value of Fraser Papers’ long-lived assets.

Employee Future Benefits
Fraser Papers sponsors various defined benefit and defined contribution pension plans, which cover substantially all employees and are funded in accordance with applicable plan and regulatory requirements. The benefits under Fraser Papers’ defined benefit pension plans are generally based on an employee’s length of service and their highest five years’ average salary. The plans do not provide for indexation of benefit payments. Hourly employees are generally members of negotiated plans. Fraser Papers also provides non-pension post-retirement benefits to certain eligible retirees, consisting of medical and dental benefits, which are funded on a “pay-as-you-go” basis.

The measurement date for all defined benefit plans is December 31. The obligations associated with Fraser Papers’ defined benefit pension plans are actuarially valued using the projected unit credit method pro rated on pensionable services, management’s best estimate assumptions for expected investment performance, salary escalation, health care cost trend rates, expected mortality rates and a current market discount rate. For the purpose of calculating the expected return on plan assets, those assets are measured at fair value. Prior service costs related to plan amendments and transitional assets are amortized on a straight-line basis over the estimated average remaining service lives ("EARSL") of the employee groups. The net actuarial gains or losses in excess of 10% of the greater of the accrued benefit obligation and the fair value of plan assets are amortized on a straight-line basis over EARSL.

Asset Retirement Obligations
Fraser Papers’ asset retirement obligations relate primarily to closure costs for landfill sites at Fraser Papers’ operating locations. The liability associated with these sites is reduced as these obligations are paid and the asset associated with these obligations is depreciated over the estimated useful life of the related facility. Revisions to the liability could occur due to changes in the estimated costs or timing of closures or new regulations affecting these closures.

Revenue Recognition
Net sales are recognized when the title and risks of ownership pass to the purchaser and are governed by standard industry terms and, in some cases, by contract. Generally, title passes when goods are shipped for paper and lumber and when received by the customer for pulp. Revenue is not recognized prior to completion of all relevant terms. Net sales are net of freight costs, commissions, discounts and rebates to customers.

Translation of Foreign Currencies
The United States dollar is the reporting currency of Fraser Papers and the functional currency of its operations.

Monetary assets and liabilities denominated in currencies other than the United States dollar are translated at the rate of exchange prevailing at year end. Gains or losses on translation of these items are included in the consolidated statements of operations. Realized gains or losses on transactions that hedge these items are also included in the consolidated statements of operations.

Stock-based Compensation

The Company issues stock options pursuant to a stock option plan, which is described in *note 10*. The Company accounts for stock options using the fair value method. Under this method, compensation expense for stock options is measured at fair value at the grant date using the Black-Scholes valuation model and is recognized over the vesting period of the options granted.

The Company has two deferred share unit plans which provide certain directors and senior officers of the Company with an opportunity to invest a portion of their compensation in deferred stock units. Deferred stock units are subject to vesting periods at the discretion of the Board of Directors. Payments under the plans are made in cash only. The expense associated with these stock units is recognized over the vesting period. The liability associated with these plans is measured based on the fair value of the vested units which is based on the current market price of the shares of the Company.

Financial Instruments

The Company has classified accounts receivable as loans and receivables and are measured at amortized cost. The Company's interest in Katahdin Paper Company LLC ("Katahdin") is classified as an available-for-sale investment, but does not have a quoted market price and is measured at cost. Bank indebtedness, accounts payable and accrued liabilities and long-term debt are also measured at amortized cost and are classified as other financial liabilities. The Company does not have any financial assets or liabilities classified as held for trading or held-to-maturity investments. The fair values of financial instruments approximate their carrying values, except where disclosed elsewhere in these notes. Fair values disclosed are determined using quoted market prices or as provided by counterparties.

Transaction costs directly attributable to the acquisition or issuance of financial liabilities are added to or netted against the carrying amount of the financial liabilities and amortized over their expected life.

Fraser Papers does not use derivative financial instruments for speculative purposes. In accordance with Section 3865, the Company documents its risk strategy objectives and the relationship between the hedging instrument and hedged item. The Company also assesses the effectiveness of the hedging relationships throughout their term to ensure they remain consistent with the Company's risk strategy.

Fair value hedges are used to manage the Company's exposure to changes in value of assets and liabilities held in a foreign currency. The carrying amount of the hedged item is adjusted for gains and losses attributable to the risk being hedged, the derivative is re-measured at fair value and the gains and losses from both are recorded in the consolidated statements of operations.

Cash flow hedges are used to reduce variability in cash flow that is attributable to changes in foreign exchange rates or commodity prices associated with forecasted transactions. The effective portion of the unrealized gain or loss on the hedging instrument is recognized in other comprehensive income. Any ineffective portion is recorded in the consolidated statements of operations. Amounts accumulated in other comprehensive income are reclassified into the consolidated statements of operations as the gain or loss on the hedged item is realized.

Emerging Accounting Pronouncements

In February 2008, the CICA's Accounting Standards Board announced that Canadian public companies will be required to adopt International Financial Reporting Standards, as issued by the International Accounting Standards Board, effective January 1, 2011. Early adoption is permissible. The Company is currently assessing the impact of adoption on its consolidated financial statements.

NOTE 2. CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2008, the Company adopted new recommendations of the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook *Section 1535, Capital Disclosures, Section 3031, Inventories, Section 3862, Financial Instruments – Disclosure* and *Section 3863, Financial Instruments – Presentation*.

Inventories
On January 1, 2008, Fraser Papers adopted new accounting recommendations of the CICA related to inventories. Under the new recommendations, spare parts inventory which has a useful life of more than one year must be classified as a long-lived asset and amortized over its estimated useful life. Previously, Fraser Papers classified certain of these spare parts as inventory and charged them to operations when put in use. The change in policy has been applied retroactively. As a result the Company has reversed certain amounts charged to operations prior to January 1, 2007 and reclassified certain inventory items to property, plant and equipment on the consolidated balance sheets. These adjustments as at January 1, 2007 resulted in an increase to property, plant and equipment of $3.2, a decrease in inventories of $0.7, an increase in future income taxes liabilities of $0.4 and a decrease in opening deficit as at January 1, 2007 of $2.1. In addition, the Company has restated its 2007 results of operations in order to reflect this change in policy. These adjustments resulted in a decrease in the consolidated loss for the year ended December 31, 2008 of $2.7 or $0.06 per share (2007 – $0.6 or $0.01 or per share), compared to if the Company had not changed its policy. Additional disclosures required by the new recommendations are provided in *note 3*.

Financial Instruments
On January 1, 2008, Fraser Papers adopted new accounting recommendations of the CICA related to disclosing information about financial instruments and risk management. These disclosures have been described in *note 12*.

Capital Disclosures
On January 1, 2008, Fraser Papers adopted new accounting recommendations of the CICA related to disclosing information about how an entity manages its capital. These disclosures have been described in *note 13*.

NOTE 3. INVENTORY

	2008	2007
Raw materials	**$ 25.4**	$ 35.4
Finished goods	**68.6**	58.2
Operating and maintenance supplies	**31.5**	30.6
	$ 125.5	$ 124.2

For the year ended December 31, 2008, Fraser Papers recorded a provision of $8.1 (2007 – $5.8) to reduce the carrying value of certain of its inventories to the lower of original cost or net realizable value. $37.3 (2007 – $40.6) of inventory is recorded at net realizable at December 31, 2008. No reversals of prior charges were recorded in 2008 or 2007.

Inventory costs recognized as an expense during the year are reported as cost of goods sold in the consolidated statements of operations.

On January 29, 2009 Fraser Papers announced the sale of approximately 10,500 tons of finished goods paper inventory to Brookfield for proceeds of approximately $11.7. Proceeds on the sale were used to repay amounts owing on the Company's revolving credit facility. In addition, the Company has agreed to supply paper to Brookfield through July 31, 2009, at market prices less a merchant's discount of 3.5%. Fraser Papers will provide sales and administrative support to Brookfield.

NOTE 4. PROPERTY, PLANT AND EQUIPMENT

2008	**Cost**	**Accumulated Depreciation**	**Net Book Value**
Pulp and paper mills	**$ 895.0**	**$ (659.7)**	**$ 235.3**
Lumbermills	**115.6**	**(94.9)**	**20.7**
	$1,010.6	**$ (754.6)**	**$ 256.0**

2007	**Cost**	**Accumulated Depreciation**	**Net Book Value**
Pulp and paper mills	$ 868.3	$ (626.8)	$ 241.5
Lumbermills	117.7	(93.0)	24.7
	$ 986.0	$ (719.8)	$ 266.2

NOTE 5. OTHER ASSETS

	2008	2007
Pension plans *(note 8)*	**$ 44.6**	$ 43.2
Investment in Katahdin Paper Company LLC *(note 15)*	**12.6**	12.1
Deferred costs and other	**3.7**	1.2
	$ 60.9	$ 56.5

NOTE 6. LONG-TERM DEBT

	2008	2007
Revolving credit facility	**$ 48.2**	$ 81.6
Term loan facility	**16.3**	–
Term credit facility	**25.0**	–
Deferred financing costs	**(0.5)**	–
	89.0	81.6
Current portion of long-term debt	**(25.0)**	(81.6)
	$ 64.0	**$ –**

In January 2008, the Company completed a rights offering to its shareholders (the "Offering") under which it received net proceeds of $59.7. The proceeds were used to repay outstanding indebtedness including $50.0 in temporary financing, which was due January 31, 2008. Additional disclosure about the Offering is provided in *note 10*.

In April 2008, the Company amended its existing revolving credit facility to extend the term of the facility and increase the maximum borrowings under the facility to $115.0. The amended facility bears interest at market rates and is due in April 2011. Borrowings under the facility are secured by a first charge against accounts receivable and inventory of Fraser Papers. At December 31, 2008, $86.7 (2007 – $123.9) of the facility was utilized, $48.2 (2007 – $31.6) for operating bank loans and the balance in the form of letters of credit.

In June 2008, the Company entered into a term loan facility with the province of New Brunswick for up to CAD$40.0. The facility bears interest at a fixed rate of 4.7% and is due December, 2014. Borrowings under the facility will be used to fund capital expenditures at the Company's operations in New Brunswick and are secured by a first charge on property, plant and equipment located in New Brunswick. Principal payments under the loan will be made in quarterly installments over the term of the loan with a lump sum payment on maturity. The first principal repayment is due no later than March, 2010. At December 31, 2008, $16.3 (CAD$20.0) had been drawn under this facility.

In September 2008, the Company entered into a term credit facility for $25.0. Brookfield has provided a guarantee to the lenders in support of this credit facility and is required to meet certain financial covenants. The facility bears interest at market rates and is due in September 2009. At December 31, 2008, the facility was fully drawn.

During 2007, the Company closed a tender offer to repay $84.0 in principal amount of its outstanding 8.75% Senior Notes ("Notes"). The Company repaid $68.5 of Notes to the public and cancelled $15.5 of Notes held by Fraser Papers. The repayment was financed, in part, through a temporary $50.0 increase in the Company's revolving credit facility with its current lender. A write-down of deferred financing costs of $1.6, related to the repayments under the tender offer, has been reflected in the consolidated statements of operations and statements of cash flows.

The effective interest rate on long-term debt was 3.4% at December 31, 2008 (2007 – 7.5%).

During the year, the Company made interest payments of $3.0 (2007 – $8.9).

NOTE 7. OTHER LIABILITIES

	2008	2007
Post-retirement benefit plans *(note 8)*	**$ 37.5**	$ 44.2
Asset retirement obligations	**10.6**	10.8
Other	**0.3**	1.1
	$ 48.4	$ 56.1

Asset retirement obligations relate primarily to closure costs and post-closure maintenance costs for landfills at Fraser Papers' current and former operating locations. Obligations as at December 31, 2008 were reduced by $1.0 (2007 – increased by $2.3) due to revisions in estimated cash flows from the prior year. Total accretion expense for the year related to asset retirement obligations was $0.8 (2007 – $0.7). The obligations represent estimated future payments of $28.2 (2007 – $33.6) which have been discounted at a weighted average rate of 8.0%. In addition to the asset retirement obligations recorded, Fraser Papers may have other obligations in the event of a permanent shutdown of any of its operations. However, these plant assets have indeterminate lives and, therefore, the associated asset retirement obligations are not reasonably estimable and liabilities cannot be established.

NOTE 8. EMPLOYEE BENEFIT PLANS

Pension Plans

Fraser Papers has a number of pension plans, participation in which is available to all employees. Fraser Papers' obligations under its defined benefit pension plans are determined periodically through the preparation of actuarial valuations, which are required every one to three years, depending on where the plan is registered. Information about these plans is as follows:

	2008	2007
Change in Accrued Benefit Obligation During the Year:		
Accrued benefit obligation, beginning of year	**$ 643.0**	$ 588.0
Employee contributions	**2.3**	2.2
Current service cost	**6.7**	8.2
Interest on accrued benefit obligation	**32.3**	31.9
Benefits paid	**(44.2)**	(46.5)
Net actuarial gain	**(42.2)**	(19.5)
Restructuring *(note 17)*	**–**	2.8
Foreign currency exchange rate impact	**(89.1)**	75.9
Accrued benefit obligation, end of year(1)	**$ 508.8**	$ 643.0
Change in Plan Assets During the Year:		
Plan assets, beginning of year	**$ 530.5**	$ 475.4
Actual return on plan assets	**(104.7)**	14.9
Employer contributions	**19.1**	25.0
Employee contributions	**2.3**	2.2
Benefits paid	**(44.2)**	(46.5)
Foreign currency exchange rate impact	**(65.7)**	59.5
Plan assets, end of year(1)	**$ 337.3**	$ 530.5
Reconciliation of Funded Status:		
Accrued benefit obligation	**$ 508.8**	$ 643.0
Plan assets	**337.3**	530.5
Accrued benefit obligation in excess of plan assets	**(171.5)**	(112.5)
Unamortized net actuarial loss	**215.9**	155.4
Unamortized prior service costs	**4.7**	7.3
Unamortized net transitional asset	**(4.5)**	(7.0)
Net accrued benefit asset	**$ 44.6**	$ 43.2

(1) All plans have accrued benefit obligations in excess of plan assets before unamortized amounts.

	2008	2007
Components of Net Pension Expense:		
Current service cost	**$ 6.7**	$ 8.2
Interest on accrued benefit obligation	**32.3**	31.9
Actual return on plan assets	**104.7**	(14.9)
Net actuarial gain	**(42.2)**	(19.5)
Restructuring(2) *(note 17)*	**1.3**	2.8
Difference between actual and expected return on plan assets	**(144.1)**	(24.9)
Difference between actual and recognized net actuarial loss	**50.7**	27.6
Difference between actual and recognized prior service costs	**1.4**	1.5
Amortization of net transitional asset	**(1.3)**	(1.1)
Net periodic pension expense	**$ 9.5**	$ 11.6

(2) In the first quarter of 2008, the Company received regulatory approval relating to a partial wind-up of pension plan obligations as a result of a disposition of timberland assets in New Brunswick in 2006 and recorded a settlement expense of $1.3 in selling, general and administrative costs.

The net actuarial gain of $42.2 is primarily the result of a change in the rate used to discount the accrued benefit obligations.

	2008	2007
Significant Weighted-Average Actuarial Assumptions:		
Used in calculation of net periodic pension expense for the year:		
Discount rate	**5.42%**	5.17%
Expected long-term rate of return on plan assets	**8.00%**	8.00%
Rate of compensation increase	**3.82%**	3.81%
Used in calculation of accrued benefit obligation, end of year:		
Discount rate	**6.18%**	5.42%
Rate of compensation increase	**3.82%**	3.81%

The weighted average asset allocation of Fraser Papers' defined benefit pension plan assets is as follows:

Asset category:		
Equity investments	**64%**	69%
Fixed income investments	**36%**	31%
Total assets	**100%**	100%

The consolidated statements of operations include $3.5 (2007 – $2.7) related to contributions to Fraser Papers' defined contribution pension plans.

Post-Retirement Benefit Plans

Fraser Papers funds health care benefits costs on a pay-as-you-go-basis. Fraser Papers' obligations under its post-retirement benefit plans are determined periodically through actuarial valuations, which are conducted no less frequently than every three years. Information about these plans is as follows:

	2008	2007
Change in Accrued Benefit Obligation During the Year:		
Accrued benefit obligation, beginning of year	**$ 60.7**	$ 62.1
Current service cost	**0.6**	0.6
Interest on accrued benefit obligation	**3.2**	3.4
Benefits paid	**(3.4)**	(3.5)
Net actuarial gain	**(9.5)**	(9.1)
Plan amendment	**0.8**	1.3
Restructuring *(note 17)*	**–**	0.5
Foreign currency exchange rate impact	**(5.6)**	5.4
Accrued benefit obligation, end of year	**$ 46.8**	$ 60.7
Reconciliation of Funded Status:		
Accrued benefit obligation	**$ 46.8**	$ 60.7
Plan assets	**–**	–
Accrued benefit obligation in excess of plan assets	**(46.8)**	(60.7)
Unamortized net actuarial loss	**7.4**	18.1
Unamortized prior service cost	**1.9**	(1.6)
Net accrued benefit liability	**$ (37.5)**	$ (44.2)
Components of Net Post-retirement Benefit Expense:		
Current service cost	**$ 0.6**	$ 0.6
Interest on accrued benefit obligation	**3.2**	3.4
Plan amendment	**0.8**	1.3
Net actuarial gain	**(9.5)**	(9.1)
Difference between actual and recognized net actuarial loss	**10.6**	10.6
Difference between actual and recognized prior service losses	**(3.5)**	(4.8)
Restructuring *(note 17)*	**-**	0.5
Net periodic post-retirement benefit expense	**$ 2.2**	$ 2.5
Significant Weighted-Average Actuarial Assumptions:		
Used in calculation of net post-retirement benefit expense for the year:		
Discount rate	**5.58%**	5.33%
Used in calculation of accrued benefit obligation, end of year:		
Discount rate	**6.22%**	5.58%
Health care cost trend rate used in calculation of accrued benefit obligation, end of year:		
Initial rate	**9.72%**	9.78%
Ultimate rate	**5.00%**	5.00%
Year ultimate rate reached	**2017**	2016
Sensitivity to change in health care cost trend rate, for year ended December 31, 2008:	**1% increase**	1% increase
Impact on net periodic post-retirement benefit expense	**0.5**	0.5
Impact on accrued benefit obligation	**4.5**	7.0

NOTE 9. INCOME TAXES

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the amounts used for income tax purposes.

Significant components of the provision for recovery of income taxes are as follows:

	2008	2007
Current tax expense	**$ (0.4)**	$ (1.4)
Future income tax recovery	**0.5**	14.8
Income tax recovery	**$ 0.1**	$ 13.4

The differences between income taxes computed using statutory tax rates and income tax as recorded are as follows:

	2008	2007
Loss before income taxes	**$ (72.0)**	$ (56.5)
Tax recovery at combined statutory rates	**23.0**	19.1
Effect of:		
Rate differences on different jurisdictions	**5.0**	0.3
Non-taxable portion of net capital gains	**1.8**	22.5
Foreign exchange and other	**(11.0)**	1.7
Change in valuation allowance	**(18.7)**	(30.2)
Income tax recovery	**$ 0.1**	$ 13.4

The income tax effects of temporary differences that give rise to future income taxes are as follows:

	2008	2007
Benefit of tax loss carry forwards	**$ 151.1**	$ 126.4
Post-employment benefits	**(1.0)**	0.2
Current future income tax assets	**5.9**	9.0
Other future income tax assets, net	**2.9**	8.1
Property, plant and equipment	**(40.6)**	(45.6)
Future income taxes	**$ 118.3**	$ 98.1
Less: Valuation allowance	**(121.5)**	(102.8)
Future income taxes, net	**$ (3.2)**	$ (4.7)
Represented by:		
Current future income tax asset	**$ 0.3**	$ 0.2
Long-term future income tax liability	**(3.5)**	(4.9)
	$ (3.2)	$ (4.7)

The benefit of tax loss carry-forwards includes the benefit of $326.4 (2007 – $272.3) of net losses in the United States which expire between 2024 and 2028. A valuation allowance of $121.5 (2007 – $102.8) has been provided against the benefit of income tax assets as it is not more likely than not that they will be realized. Included in the valuation allowance is $142.4 (2007 – $123.8) of future income tax assets related to these losses, partly offset by $20.8 (2007 – $21.0) of net future income tax liabilities. The Company has $71.7 (2007 – $63.3) of loss carry-forwards in Canada which expire between 2014 and 2027.

Income or income-related taxes of $0.6 (2007 – $2.3) were paid during the year. There is no income tax recoverable (2007 – $1.2) in accounts receivable, as at December 31, 2008.

NOTE 10. SHAREHOLDERS' EQUITY

	2008	2007
Common shares – 50,166,789 (2007 – 29,509,876) shares outstanding	**$ 549.7**	$ 490.0
Contributed surplus	**6.9**	5.7
Accumulative other comprehensive income	**2.6**	0.2
Deficit	**(274.9)**	(203.0)
	$ 284.3	$ 292.9

The authorized capital stock of the Company consists of an unlimited number of Class A preferred shares, Class B preferred shares, non-voting participating shares and common shares.

The weighted average number of shares outstanding used for calculating loss per share was 48,445,380 (2007 – 29,509,876).

In the fourth quarter of 2007, the Company filed a final short form prospectus with securities regulators in Canada relating to the Offering. Under the Offering, the Company distributed rights to existing shareholders to purchase 20,656,913 shares, at a purchase price of CAD$2.90. On January 24, 2008 the Company issued 20,656,913 shares and received net proceeds of $59.7.

Under Fraser Papers' Stock Option Plan, the Board of Directors may issue stock options to certain officers of the Company. These options have a ten year life and vest evenly over five years and are valued at the grant date using the Black-Scholes valuation model using the following assumptions:

	2008	2007
Risk-free interest rate	**3.9%**	3.9%
Volatility	**38.0%**	32.0%
Dividend yield	**0.0%**	0.0%
Expected life	**7.5 years**	7.5 years

Total compensation expense in 2008 was $1.2 (2007 – $0.9) for these stock options.

The following table summarizes the changes in options outstanding and the impact on the weighted average per share exercise price during the year:

	2008		2007	
	Number of Options	**Weighted Average Exercise Price**	**Number of Options**	**Weighted Average Exercise Price**
		(CAD$)		**(CAD$)**
Balance, beginning of year	1,630,000	$ 7.89	730,000	$ 10.79
Options granted	1,445,000	3.01	1,015,000	5.99
Options cancelled	(360,000)	5.14	(115,000)	9.50
Balance, end of year	2,715,000	$ 5.66	1,630,000	$ 7.89

The following table summarizes options outstanding and the weighted average exercise price, as at December 31, 2008:

	Options Outstanding			Options Vested and Exercisable
Year Granted	**Number of Options**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**(1)	**Number of Options**
			(CAD$)	
2004	195,000	5.7	$ 16.45	156,000
2005	10,000	6.1	14.59	6,000
2006	355,000	7.1	8.04	142,000
2007	900,000	8.1	5.99	180,000
2008	1,255,000	9.1	3.01	–
	2,715,000	8.3	$ 5.66	484,000

(1) Options granted in 2004 – 2007 were issued at the weighted average exercise price for those years. Options granted in 2008 are exercisable at prices of $2.22 to $3.10.

NOTE 11. CHANGE IN NON-CASH WORKING CAPITAL

The net change in non-cash working capital balances is comprised of the following:

	2008	2007
Cash provided by (used for):		
Accounts receivable	**$ 27.8**	$ 10.6
Inventory	**(1.2)**	(7.5)
Accounts payable and accrued liabilities	**(17.0)**	14.1
	$ 9.6	$ 17.2

NOTE 12. FINANCIAL INSTRUMENTS

Foreign Currency Rate Risk

Fraser Papers holds assets and liabilities in Canadian dollars and incurs a significant portion of its costs in Canadian dollars. From time to time Fraser Papers enters into forward foreign exchange contracts to hedge the impact of foreign exchange rate changes on these assets, liabilities and costs. Fraser Papers does not use derivative financial instruments for speculative purposes.

As at December 31, 2008, the Company has outstanding forward foreign exchange contracts of $41.0 (2007 – $30.2), which are designated as a fair value hedge against certain Canadian dollar-denominated net monetary liabilities. The consolidated statements of operations for the year ended December 31, 2008 include a realized loss of $7.6 (2007 – gain of $8.0) on matured forward foreign exchange contracts and an unrealized loss of $0.1 (2007 – gain of $0.2) on outstanding contracts. These realized and unrealized gains or losses are offset by realized and unrealized losses or gains on the net monetary liabilities being hedged.

As at December 31, 2008, the Company has forward foreign exchange contracts of $91.5 (2007 – $42.4) as a hedge of anticipated future Canadian dollar cash outflows and no contracts (2007 – $60.0) as a hedge of anticipated future Canadian dollar cash inflows. These contracts have varying maturity dates in 2009. The consolidated statements of operations for the year ended December 31, 2008 include a realized loss of $4.0 (2007 – gain of $2.5) on matured forward foreign exchange contracts. An unrealized gain of $3.4 (2007 – $0.4) is recorded in other comprehensive income. These contracts effectively fix the exchange rate at which certain anticipated future Canadian dollar-denominated cash flows will be incurred.

Credit Risk

Fraser Papers does not have a trade receivable balance greater than $5.8 from any individual customer as at December 31, 2008 (2007 – $7.9). The Company reviews a customer's credit rating before extending or increasing credit and conducts regular reviews of existing customers' credit performance. The consolidated statements of operations for the year ended December 31, 2008 includes bad debt expense of $0.2 (2007 – $nil). The allowance for doubtful accounts as at December 31, 2008 was $0.4 (2007 – $0.2).

Earnings Sensitivity

Fluctuations in market prices expose the Company to potential negative effects from market risk, which is composed of changes in currency exchange rates (currency risk), changes in interest rates (interest rate risk) and changes in the selling prices of the Company's products (price risk).

Currency Risk

With production facilities in Canada, a significant portion of the Company's operating costs are sourced in Canadian dollars. For the year ended December 31, 2008, a US$0.01 change in the foreign exchange rate would have impacted pre-tax loss, before the impact of the Company's hedging program, by $3.6.

Interest Rate Risk

Interest rates on the Company's borrowings are subject to change and could affect the profitability of the Company. The Company currently manages its interest rate risk by maintaining three borrowing facilities to support its liquidity requirements. One of these facilities attracts interest at a fixed rate of 4.7% while the others attract interest at floating rates. Interest rate swaps are an available alternative to further reduce the Company's exposure to fluctuations in interest rates. For the year ended December 31, 2008, a 100 basis point change in market interest rates would have impacted pre-tax loss by $0.5.

Price Risk
Markets for some of Fraser Papers' products are highly cyclical in nature. From time to time, Fraser Papers enters into commodity futures contracts which serve to hedge a portion of Fraser Papers' future sales against changes in the selling price for these products. Fraser Papers does not use derivative financial instruments for speculative purposes.

The Company is exposed to variability in commodity prices on the sale of its paper, pulp and lumber products. A $25 per ton change in the value received on the sale of paper products would have impacted pre-tax loss for the year ended December 31, 2008, by $14.1. A $25 per tonne change in pulp prices would have affected pre-tax loss for the year ended December 31, 2008, by $1.3. For the year ended December 31, 2008, pre-tax loss would have been impacted by $4.8 with a change in lumber prices of $25 per Mbfm. The Company considers the use of pulp and lumber hedges to limit its exposure to variability in pricing.

During the year, Fraser Papers entered into lumber futures contracts representing 30.8 million board feet of lumber (2007 – 13.2), which effectively fixed the selling price for lumber delivered on the expiry date and were designated as a hedge of a portion of future lumber sales. These contracts matured in the fourth quarter of 2008 and first quarter of 2009 and are highly effective at mitigating the impact of changing lumber prices. The consolidated statements of operations for the year ended December 31, 2008 include a realized gain of $0.7 (2007 – $0.6) on matured lumber futures contracts and an unrealized gain of $0.7 (2007 – nil) is recognized in other comprehensive income during year. There is no hedge ineffectiveness on these contracts. Contracts representing 1.7 million board feet of lumber (2007 – nil) were outstanding at December 31, 2008.

NOTE 13. CAPITAL MANAGEMENT

The Company monitors capital on the basis of the net debt to net debt plus equity ratio. Net debt is bank indebtedness plus long-term debt, less cash and cash equivalents. Equity comprises all components of shareholders' equity.

The Company seeks to maintain a conservative net debt to net debt plus equity ratio while maintaining adequate liquidity to achieve its business plans. Fraser Papers manages the term of its debt with consideration to the expected life of its net assets. As such, shareholders' equity is maintained at amounts in excess of the carrying value of property, plant and equipment. The Company's current net debt to net debt plus equity ratio is 25%. In order to maintain or modify the capital structure the Company has a number of alternatives, subject to certain approvals, including: issue additional shares; repurchase of its own shares on the market; return capital to shareholders; and the issuance of, or repayment of debt.

NOTE 14. COMMITMENTS AND CONTINGENCIES

Guarantees
Brookfield has provided guarantees to the lenders of the Company in support of its credit facilities. The maximum amount of the guarantees is $50.0. Fraser Papers has provided Brookfield with a guarantee that it will repay Brookfield any amounts paid by Brookfield to Fraser Papers' lenders. The guarantees are secured by a fixed charge on certain of Fraser Papers' assets.

Norbord has provided guarantees for certain obligations of Fraser Papers under a financial commitments agreement (the "FCA"). These guarantees were previously obligations of the paper division of Norbord. At December 31, 2008, the maximum potential amount of the obligations guaranteed was estimated to be $1.0 (2007 – $4.4).

Under the FCA, Fraser Papers agreed to provide letters of credit or other acceptable collateral to secure any guarantees outstanding on December 31, 2008. As security for these ongoing financial commitments to Fraser Papers, Norbord has the right, at any time, to require Fraser Papers to provide a fixed first charge security interest over certain of Fraser Papers' manufacturing facilities.

Other

Fraser Papers has entered into various commitments for the future supply of operating services and materials. Commitments under employee benefit plans, operating leases and other obligations for which the cash flows are fixed or determinable at December 31, 2008, are:

	Employee Benefit Plans	Operating Leases and Other	Total
2009	$ 30.8	$ 23.2	$ 54.0
2010	35.4	0.3	35.7
2011	41.7	0.2	41.9
2012	30.9	0.1	31.0
2013	18.0	–	18.0
Subsequent	61.5	–	61.5
	$ 218.3	$ 23.8	$ 242.1

NOTE 15. RELATED PARTY TRANSACTIONS

Fraser Papers purchased $4.8 (2007 – $5.7) of electricity for its Gorham paper mill, from Brookfield and its affiliates. Included in accounts payable and accrued liabilities is $1.0 (2007 – $0.5) related to these purchases.

Fraser Papers has invested in convertible, preferred units (the "Units") of Katahdin, an indirectly, wholly owned subsidiary of Brookfield. The Units earn a preferential cumulative distribution of 5% per annum. Cumulative distributions accrued on this investment amount to $2.6 (2007 – $2.1).

Fraser Papers has leased certain productive equipment owned by Katahdin. The lease payment amounts are determined with reference to the profits generated by those assets such that all of the profits earned by Fraser Papers on those assets, net of a management fee, are remitted to the lessor as lease payments. During the year, Fraser Papers earned a management fee of $7.5 (2007 – $8.0) from Katahdin. Included in accounts receivable is $0.6 (2007 – $2.5) related to these fees.

During 2008, Fraser Papers sold $1.7 (2007 – $3.3) of goods and services to Katahdin. Included in accounts receivable is $0.1 (2007 – $0.8) related to these sales.

Fraser Papers has entered into 20 year fibre supply agreements with Acadian. During the year, purchases of fibre from Acadian amounted to $26.1 (2007 – $33.6). Included in accounts payable and accrued liabilities is $1.0 (2007 – $1.0) related to these purchases. The Company paid $1.5 (2007 – $0.8) to Acadian as a fee for administering the Company's Crown Licenses. The Company's prior equity interest in the Acadian generated distributions of $2.3 in 2007.

Subsequent to December 31, 2008, Fraser Papers announced the sale of approximately 10,500 tons of finished goods paper inventory to Brookfield for proceeds of approximately $11.7. In addition, the Company has agreed to supply paper to Brookfield through July 31, 2009, at market prices less a merchant's discount of 3.5%. Fraser Papers will provide sales and administrative support to Brookfield.

In connection with the Offering, Fraser Papers entered into a Standby Purchase Agreement with Brookfield, in which Brookfield agreed to exercise all of its rights and would purchase any common shares not otherwise subscribed for by other shareholders of the Company. As a result, Brookfield paid CAD$54.6 to acquire 18,813,241 shares, increasing their ownership interest to 70.5% of the Company.

Brookfield has provided the Company with a facility with a notional amount of $350.0 to enter into forward foreign exchange contracts as part of the Company's hedging activities. At December 31, 2008, the Company has entered into forward foreign exchange contracts of $41.0 (2007 – $30.2) as a hedge against certain Canadian dollar-denominated net monetary liabilities, nil (2007 – $60.0) as a hedge of anticipated future Canadian dollar cash inflows and $100.3 (2007 – $35.2) as a hedge of anticipated future Canadian dollar cash outflows, under this facility.

The Company has agreed to pay guarantee fees to Brookfield in connection with guarantees to Fraser Papers' lenders in support of Fraser Papers' credit facilities. The fees are equal to an annualized rate of approximately 2.0% of the maximum amount of the guarantees of $50.0 (or $1.0 per year).

Fraser Papers is dependant on the continued financial support of Brookfield. Without this support, it is possible that the Company may not be able to secure alternative sources of financing with terms that are satisfactory to the Company (see also *note 14*).

All related party transactions are recorded at the exchange amount.

NOTE 16. SALE OF EQUITY INVESTEE

On September 26, 2007, Fraser Papers sold its interest in Acadian for net proceeds of $38.4, which were received in the fourth quarter of 2007. As the units in Acadian had a book value of nil, a gain of $38.4 was recorded on the transaction.

NOTE 17. CLOSURE OF PAPER MANUFACTURING CAPACITY

During the second quarter of 2007, Fraser Papers permanently shut down two uncoated freesheet paper machines at its East Papers operations. As a result, Fraser Papers recorded a restructuring charge of $15.9 including an impairment charge related to property, plant and equipment and spare parts inventory of $9.2 and other costs of $6.7.

NOTE 18. SEGMENTED INFORMATION

Geographic Segments

Net sales by geographic segment are determined based on origin of shipment and therefore include export sales.

	Net Sales		**Property, Plant and Equipment**	
	2008	2007	**2008**	2007
United States	**$ 590.1**	$ 588.7	**$ 121.4**	$ 131.2
Canada	**98.5**	126.0	**134.6**	135.0
Combined total	**$ 688.6**	$ 714.7	**$ 256.0**	$ 266.2

Operating Segments

As an integrated producer of paper and pulp as its principal business, Fraser Papers has one reportable segment. Its lumbermill operations are an integral part of its overall business as these facilities provide fibre for the internal production of pulp.

NOTE 19. COMPARATIVE FIGURES

Certain comparative figures have been reclassified from those previously presented to conform to the current year's presentation.