

FraserPapers

ANNUAL REPORT 2008

Corporate Profile

Fraser Papers is an integrated specialty paper company that produces a broad range of specialty packaging and printing papers. The company has operations in New Brunswick, Maine, New Hampshire and Quebec.

Fraser Papers is listed on the Toronto Stock Exchange under the symbol: FPS. For more information, visit the Fraser Papers web site at www.fraserpapers.com

Financial Highlights

<i>(US\$millions, except per share data)</i>	2008	2007	2006
Net sales ⁽¹⁾	\$ 688.6	\$ 714.7	\$ 795.9
EBITDA ⁽²⁾	(33.6)	(41.9)	(7.2)
Loss ⁽²⁾	(71.9)	(43.1)	(113.8)
Total assets ⁽²⁾	510.6	546.2	554.2
Net debt	96.4	85.9	53.9
Number of common shares outstanding ⁽³⁾	50.2	29.5	29.5
Loss per share, basic and diluted ⁽²⁾	\$ (1.48)	\$ (1.47)	\$ (3.86)
Total paper produced (000 tons)	570	608	661

(1) Net sales are gross sales, net of freight costs, commissions, and discounts and rebates to customers.

(2) Prior years adjusted for changes in accounting standards.

(3) Millions of shares.

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Letter to Shareholders

OVERVIEW

Our business, having half its assets located in eastern Canada as well as exposure to lumber markets and dependence on oil, was not well positioned to absorb the impact from unprecedented input cost inflation and strength in the Canadian dollar during 2008. We acted with a sense of urgency and found ways to become significantly more energy efficient; we expanded internal pulp production to lower costs and reduced purchases of expensive market pulp; we curtailed redundant capacity and cut fixed costs. Finally, we realized higher prices for our paper and pulp products while continuing to grow sales of high value specialty papers. That said, our EBITDA loss of \$34 million, while improved over last year, was unacceptable by any measure.

PROGRESS

Despite the disappointing results, we did take a number of steps forward to permanently position Fraser Papers in a better place for the future.

Cash requirements to support our business and meet our pension funding obligations were significant and we completed a number of financings during the year. With the support of Brookfield Asset Management, we raised C\$60 million of equity from a fully-underwritten rights offering to shareholders, expanded our revolving term facility by \$25 million and secured an additional \$25 million under a separate one year term facility. In addition, the Province of New Brunswick agreed to provide a CAD\$40 million six year term loan to finance upgrades at both our Edmundston pulp mill and our Plaster Rock lumbermill.

We grew our **value-added** paper business. We increased shipments of packaging papers by 11% and high-bright groundwood papers by 35% while reducing sales of commodity papers. The two specialty paper grades are key to our longer term business strategy as we see opportunities to grow in these segments while the broader market trends for many other paper grades are in decline.

We achieved a 7% increase in the average realized price of our paper, equivalent to \$60 per ton. This generated an additional \$34 million in revenue.

Our **pipeline of new products** was expanded and now includes approximately 50 new projects at various stages of development from concept to commercial launch. During the year, we launched a significant number of new products. We estimate the combined benefit from all product mix improvements added \$13 million to our bottom line.

We also **closed the gap in operating performance** that we felt had previously existed with our peers in the industry. Productivity and throughput increased by 6% at the paper mills. Our capital projects at the Edmundston pulp mill provided the returns we expected with a similar 6% improvement in throughput. As the price of oil rose to historic levels, we reduced energy consumption across the Company, saving the equivalent of 120,000 barrels of oil during the year.

The improved operating performance also reflects management operating systems and reporting that are **driving better execution of daily operating plans**. The impact from all productivity and efficiency initiatives in our facilities was approximately \$17 million during 2008.

CONTINUING OPPORTUNITIES

At the end of the year, it was clear that we were facing a new set of challenges from a global recession and credit crisis. We have adapted and our operating priorities for the coming year have become very clear:

- Manage the business for cash to minimize requirements to fund the operations. This means driving out even more costs in the business and taking downtime in our operations, rather than financing inventories as we might have in the past. The three key areas of cost reduction continue to be fibre, energy and labour. The latter issue includes the higher funding requirements for our pension and health benefits.
- Simplify our business processes, expedite decisions and increase our operating flexibility so that we can prioritize and respond quickly to every new opportunity presented to us. We need to take full advantage of being a small company with a flat organizational structure.

- Continue to leave commodity grades of paper for those who have lower cost capacity and focus on new specialty products in packaging and print applications in niche segments where we see growth and an advantage. This especially involves products with “green” attributes through forest certification, recycled content or low carbon footprint.
- Complete the ongoing energy projects that have reduced our exposure to oil. This will ensure we are able to compete when oil prices return to \$80 per barrel or more.

SUMMARY AND OUTLOOK

We expect the coming year to be as challenging as our last two years as the impact of a global recession plays out in the markets in which we compete. Our backlogs slowed sharply in December of 2008 forcing us to take market-related downtime, first on our paper machines and latterly at the pulp mills as well. The pulp and lumber markets were particularly impacted with market prices dropping to cyclical lows. Prices for our paper products have held better, but volumes have not. We expect to operate with significant downtime during the first quarter and look for confidence in the economy to be gradually restored over the remainder of the year.

The benefit from current lower prices for a number of key inputs has already improved our cost structure. When these lower costs are combined with current initiatives, they should provide the opportunity to generate an acceptable margin in our paper business, assuming operations can return to full capacity. Further, with \$350 million of annual expenditures denominated in Canadian dollars, the weakness in the Canadian/U.S. exchange rate has added to the competitiveness of our operations. To mitigate a significant amount of risk related to future volatility in the Canadian dollar, we have bought forward approximately 40% of our 2009 Canadian dollar requirements at approximately 79 U.S. cents.

Given where we are today, we will require additional financing during 2009 to fund our operations, meet our pension funding obligations and refinance the \$25 million term loan facility maturing in September. As conditions remain uncertain in the credit markets, we will have to issue either debt or equity with the support of our shareholders.

In February 2009, the Board appointed Jeff Dutton as President and Chief Operating Officer of the Company. Jeff joined Fraser in 2006 as General Manager of our East Papers operations where he successfully led the turnaround of our core pulp and paper operations. With over twenty years experience in the industry, he has earned the respect of our employees and is well equipped to lead our organization during this challenging time.

We made significant progress in 2008 and remain committed to our business strategy, believing that Fraser Papers can operate as a competitive specialty paper company over the longer term. On behalf of all the employees at Fraser, we acknowledge your patience and support through these difficult years.



J. Peter Gordon
Chief Executive Officer
March 10, 2009

Management's Discussion & Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") presents the factors that had a material effect on our results of operations during the years ended December 31, 2008 and 2007. Also discussed is our financial position as of the end of those periods. This discussion should be read in conjunction with our historical consolidated financial statements as at December 31, 2008 and 2007 and for the years then ended, and the notes thereto. Our consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). This MD&A contains forward-looking statements (see "Forward-Looking Information").

The United States dollar is our reporting currency and the functional currency of all our operations. All figures herein are in United States dollars unless otherwise noted.

In this MD&A, "Fraser Papers", "we", "our" and "us" mean Fraser Papers Inc. and all of its subsidiaries while "Company" means Fraser Papers Inc. as a separate corporation. "Brookfield" means Brookfield Asset Management Inc. (a related party by virtue of a controlling equity interest in the Company) and all of its subsidiaries. Brookfield owns approximately 70.5% of all outstanding common shares of the Company.

EBITDA, net debt, net debt to net debt plus equity, free cash flow and cash costs are non-GAAP measures described in the Definitions section. Non-GAAP measures do not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other companies. There are no directly comparable GAAP measures to any of these measures. A quantitative reconciliation of each non-GAAP measure to the nearest comparable GAAP measure is provided at the end of this MD&A.

INTRODUCTION

This MD&A is intended to provide investors with an understanding of the historical performance of our business, its financial condition and its prospects.

Our fourth quarter 2008 MD&A dated February 5, 2009 relating to our unaudited interim consolidated financial results and notes thereto for the three month period ended December 31, 2008 is specifically incorporated by reference herein.

BUSINESS PROFILE

Fraser Papers is an integrated specialty paper company that produces a broad range of specialty packaging and printing papers. We also produce northern bleached hardwood kraft pulp and dimension lumber. Fraser Papers employs approximately 2,400 people and has operations in New Brunswick, Maine, New Hampshire and Quebec. The geographical breakdown of property, plant and equipment at the end of 2008 was 47% U.S. and 53% Canada.

Principal manufacturing facilities included:

- nine operating paper machines at two paper mills in Madawaska, Maine and Gorham, New Hampshire; additionally, two paper machines at Gorham, New Hampshire are not operating due to market-related conditions.
- one market pulp mill, producing northern bleached hardwood kraft pulp in Thurso, Quebec;
- one integrated pulp operation in Edmundston, New Brunswick, producing bleached softwood sulphite pulp and groundwood pulp; and
- four lumbermills in Plaster Rock and Juniper, New Brunswick and Masardis and Ashland, Maine.

The annual production capacity of these facilities at December 31, 2008 was:

- 650,000 tons of paper, including towel;
- 460 million board feet of lumber;
- 250,000 tonnes of market pulp;
- 270,000 tonnes of internally used sulphite pulp; and
- 120,000 tonnes of internally used groundwood pulp.

In addition, we manage the facilities of Katahdin Paper Company LLC ("Katahdin"), an affiliate of Brookfield, for a management fee.

STRATEGY

Our business strategy continues to be:

- Focusing on **value-added products**, with an emphasis toward specialty applications for packaging, printing and groundwood paper grades;
- Receiving recognition for the value proposition that our **superior customer service and technical support** provide to our customers;
- Continuing **innovation** and **development of new products** to support ongoing growth of our business;
- Achieving **operating excellence** that surpasses industry benchmarks for manufacturing efficiency, energy consumption and fibre costs at all our facilities; and
- Maintaining a culture focused on **execution and performance**.

In addition to executing this strategy, we will continue to look for opportunities to grow our specialty paper franchise opportunistically, based on value. We have significantly narrowed our operational focus in recent years such that future growth can be specifically targeted to our core business.

Value-added Products

Fraser Papers competes in specific market segments with particular expertise in the manufacture of lightweight freesheet and groundwood papers for a number of specialty applications. Our focus is on select printing and consumer packaging applications. Typically, these discrete market segments are small relative to the broader North American commodity markets and are a good match for our paper machine capabilities and capacities. We focus on markets which are generally between 50,000 to 500,000 tons in size and provide Fraser Papers with the opportunity to have an influential market share. Over time, we seek to grow the volume of business we have in these core paper market segments where we feel we can achieve the best margins. These market segments involve food and other consumer packaging paper grades, financial printing and other lightweight freesheet papers, and specialty high-bright groundwood papers. Fraser Papers has increased shipments of specialty papers from 69% of total paper shipments in 2007 to 74% in 2008.

To better serve our customers' needs, Fraser Papers has the technical capability to produce high quality printing papers as a freesheet or a groundwood product. This enables our customers to receive additional value from Fraser Papers' product offerings.

Superior Customer Service and Technical Support

Fraser Papers' customer service team is continually seeking solutions to customers' needs. We offer vendor managed inventory programs and just-in-time service where quick turnaround solutions are required.

Fraser Papers' technical support team is regularly in our customers' manufacturing locations helping them lower the overall cost of their process that uses our paper, as well as resolving issues unrelated to the paper we sell them.

We work closely with a number of packaging customers to assist them in areas such as improving converting efficiency with new packaging designs and increasing customer production rates to help the customer improve overall performance.

Innovation

Product development continues to be an important component of Fraser Papers' marketing initiatives. Our strategy is to focus on products that bring value from the service and technical features that differentiate us from our competition. We are developing new products in the label and food service markets as well as new technologies for use in our operations in areas of fibre development and pigment optimization.

During 2008, we developed 31 new specialty products for applications in the consumer packaging, financial printing, converting and label papers market segments. We achieved our goal of continually developing new products as approximately 18% of the volume in 2008 represents products that were developed in the past 24 months.

Improved Operating Performance

The manufacture of pulp and paper is a capital intensive business requiring significant investment in large machinery and equipment. It is imperative that these assets perform consistently at a high level in order to ensure the lowest possible cost position. To this end, we have undertaken a number of initiatives expected to lower our operating costs.

- Improved productivity at our sulphite pulp mill in Edmundston, New Brunswick supports our objective of displacing purchased pulp fibre with lower cost internal pulp. In 2008, internal sulphite pulp production at Edmundston averaged a record-setting 688 tons per day, a 41 ton-per-day improvement from the average in 2007.
- Throughput improvements at our Madawaska, Maine paper mill have increased sales volumes. In 2007, the Madawaska paper mill produced 438,000 tons of paper which included 32,000 tons from two paper machines that were permanently shut in the summer of 2007, giving an average of 1,178 tons per day on the remaining six paper machines. In 2008, the mill produced 1,227 tons per day, a 4% relative improvement realized through reliability and efficiency improvements.

- The Gorham, New Hampshire paper mill has also improved its throughput. During 2007 and 2008, the Gorham paper mill indefinitely shut two paper machines. The remaining three paper machines increased throughput by 11% from 323 tons per day in 2007 to 359 tons per day in 2008.
- An oil fired boiler and turbine in the Edmundston, New Brunswick pulp mill, which was traditionally used in the winter, was shut in 2007. In 2008, oil consumption at East Papers was lower by 4.3 million gallons, or 51% compared to 2007, reducing our oil consumption to 0.22 barrels per ton of paper produced and representing annual savings of \$5.4 million.
- A heat recovery system was installed and commissioned at the Thurso, Quebec pulp mill. In 2008, oil consumption at Thurso was lower by 2.3 million gallons or 11% compared to 2007, representing annual savings of approximately \$3.0 million.

Margin Improvements

Fraser Papers' margin improvement initiatives focus on year-over-year improvements in EBITDA assuming constant selling prices, exchange rates and commodity prices. Through focusing on things we can control, Fraser Papers' operating performance improved EBITDA by \$30.2 million in 2008 when compared to 2007. However, 2008 results were negatively impacted by \$10.2 million, primarily due to planned maintenance downtime at the East Papers pulp mill in Edmundston, New Brunswick and an unscheduled maintenance outage at the Thurso pulp mill. Results were also negatively affected in 2007 by \$18.6 million, primarily as a result of planned maintenance outages at East Papers and Thurso.

<i>(Pre-tax US\$millions)</i>	2008 Margin Improvements
Improved sales mix	\$ 13.0
Improved energy and chemical efficiency	11.5
Improved fibre and material utilization	3.3
Labour and other cost reductions	2.4
Total	\$ 30.2

Margin improvements were derived primarily from improved product mix, energy usage and improved chemical and fibre usage efficiencies. We have continued to optimize our manufacturing processes compared to 2007 through improving machine efficiencies, improving production scheduling and speeding up the paper machines. Paper production per operating day on our nine paper machines is up 6% compared to 2007. We believe that a more efficient operating platform will position Fraser Papers to benefit when demand for paper improves.

These initiatives served to only partially offset significant cost pressures from fibre, energy and chemical pricing and Canadian / U.S. foreign exchange, which totaled \$52.4 million in 2008 compared to 2007.

<i>(Pre-tax US\$millions)</i>	2008 Uncontrollable Pressures
Increased fibre pricing	\$ (14.3)
Increased energy pricing	(14.6)
Increased chemical pricing	(10.2)
Canadian / U.S. foreign exchange	(13.3)
Total	\$ (52.4)

Increased fibre pricing includes the impact of higher costs for logs, chips and purchased pulp. Since Fraser Papers sells and also purchases market pulp, the negative impact of purchased fibre pricing has been partially offset by improved revenue realizations in the pulp operations of \$6.4 million.

Increased energy pricing includes the impact of higher costs for oil, biomass and electricity. The Company has invested capital to reduce our reliance on oil, including the energy reduction projects at East Papers and Thurso. The Company recently approved a capital investment for a biomass boiler at the Plaster Rock, New Brunswick lumbermill to eliminate the use of oil required to dry lumber in the kilns. We also completed a scheduled maintenance and turbine overhaul at the Edmundston cogeneration boiler which improves our energy platform.

In the past, certain chemical prices have trended with the price of oil since many chemical products are petroleum-based. Chemical companies implemented significant price increases during 2008. While oil pricing subsided during the fourth quarter of 2008, chemical prices did not. Fraser Papers is working with suppliers to manage the impact of the increases.

Approximately 53% of Fraser Papers' assets are located in Canada but essentially 100% of our sales are transacted in U.S. dollars. From time to time, the Company will enter into arrangements to fix the exchange rate on certain of its Canadian dollar-denominated cash flows (see "Hedging Activities"). The Canadian dollar exchange rate realized in 2008 was US\$0.95 (after giving effect to the Company's hedging program) compared to the realized US\$0.93 in 2007.

OVERVIEW

We are executing a comprehensive turnaround of Fraser Papers' financial and operating affairs. During 2008, we continued our focus on operational improvement, implemented a number of energy and fibre efficiency initiatives and took downtime at our market pulp mill and lumbermills in an effort to reduce costs. Despite these initiatives to improve Fraser Papers' performance and improved prices of our paper and pulp products, weak lumber markets, high energy prices and a strong Canadian dollar led to negative EBITDA for 2008.

During the last half of 2008, a worldwide credit crisis developed followed quickly by a significant decline in world equity values and reduced economic activity. As a result, it is expected that many of the world's largest economies are currently in a recession. In the fourth quarter of 2008, demand for certain of Fraser Papers' pulp and paper products also fell significantly. Specifically, demand for commodity grades of pulp and paper, certain label papers, lighter-weight printing freesheet papers and high-bright groundwood papers fell as a result of reduced economic activity in the banking and manufacturing sectors. Our packaging papers appear to be less affected by the recent economic downturn.

Our specialty paper business at East Papers is benefitting from investments that have increased internal pulp and paper production, reduced energy consumption and developed and enhanced its specialty product offerings. Sulphite pulp production at the Edmundston, New Brunswick facility set a record daily production rate for the year by producing 688 tons per day, surpassing the 2007 level by 41 tons per day or 6%. The East Papers operations improved paper production by 49 tons per operating day from 2007. Energy efficiency projects in all operations reduced oil consumption by 227,000 barrels; a 32% reduction compared to 2007.

A sharp reduction in global demand for world pulp was experienced in the fourth quarter. Announced worldwide pulp mill closures for 2008 and 2009 are estimated to be in excess of 3 million tonnes of annual capacity. Worldwide hardwood pulp inventories increased to 60 days resulting in significantly reduced pricing. As a result, we were forced to take market-related downtime at the Thurso pulp mill and expect further downtime in 2009.

Fraser Papers' lumber operations have seen a significant reduction in demand over the past 18 months as North American housing starts fell throughout 2007 and 2008. The continued weak housing markets have depressed demand for lumber and other building products. Our lumber operations, which are an essential source of softwood fibre for our core pulp and paper operations in the form of wood chips and biomass fuel, operated at only 44% of capacity and continue to generate negative earnings. Under current market conditions, over 50% of the lumbermills in Eastern Canada are shut, reducing the available supply of woodchips and putting upward pressure on the price of this key input for our business.

Fraser Papers continues to focus on achieving better performance across all operations with improvements in throughput, process efficiencies and the lowest possible cost structure in order to produce paper that we can sell profitably into growing market segments.

Summary of Quarterly Results

<i>(US\$millions, except per share amounts)</i>	Net Sales	Earnings/(Loss)	Earnings/(Loss) per share <i>(basic and diluted)</i>
2008			
4th Quarter	\$ 165.5	\$ (15.9)	\$ (0.32)
3rd Quarter	162.1	(21.3)	(0.42)
2nd Quarter	180.3	(15.6)	(0.31)
1st Quarter	180.7	(19.1)	(0.44)
2007			
4th Quarter ⁽¹⁾	186.3	(20.3)	(0.69)
3rd Quarter ⁽¹⁾⁽³⁾	172.3	24.7	0.84
2nd Quarter ⁽¹⁾⁽²⁾	181.7	(37.6)	(1.28)
1st Quarter ⁽¹⁾	174.4	(9.9)	(0.34)

(1) Prior year quarters' Earnings/(Loss) adjusted for accounting change related to inventory (see "Changes in Accounting Policy").

(2) The second quarter 2007 loss and loss per share include a one time restructuring charge of \$12.8 million (after tax, \$0.43 per share).

(3) The third quarter 2007 earnings and earnings per share include a one-time gain on the sale of our interest in Acadian Timber Income Fund of \$38.4 million (after tax, \$1.08 per share), additional restructuring charges of \$3.7 million (after tax, \$0.13 per share) and a one-time tax recovery of \$13.8 million (\$0.47 per share).

Select Annual Information

<i>(US\$ millions, except per share amounts)</i>	For twelve months ended or as at December 31		
	2008	2007 ⁽¹⁾	2006 ⁽²⁾
Net sales	\$ 688.6	\$ 714.7	\$ 795.9
Earnings/(Loss)	(71.9)	(43.1)	(113.8)
Earnings/(Loss) per share	(1.48)	(1.47)	(3.86)
Total assets	510.6	546.2	554.2
Total liabilities	226.3	253.3	222.3

(1) The twelve months ended or as of December 31, 2007 include a one-time gain on the sale of our interest in Acadian Timber Income Fund of \$38.4 million (after tax, \$1.08 per share), restructuring charges of \$15.9 million (after tax, \$0.54 per share) and a one-time tax recovery of \$13.8 million (\$0.47 per share).

(2) The twelve months ended or as of December 31, 2006 include included a one-time impairment charge against the Company's investment in Smart Papers LLC of \$111.4 million (after tax, \$3.66 per share) and a one-time charge for the closure of the Berlin pulp mill of \$50.3 million (after tax, \$1.70 per share).

RECENT DEVELOPMENTS

Rights Offering

In January 2008, the Company completed a rights offering and issuance of common shares to its shareholders (the "Offering"). Under the Offering, the Company issued 20,656,913 common shares for aggregate proceeds of \$59.7 million. Common shares outstanding at the conclusion of the offering were 50,166,789. The net proceeds from the Offering were used to repay drawings under the Company's credit facility.

In satisfaction of its commitment under a standby purchase agreement, Brookfield purchased a total of 18,813,241 common shares under the Offering, increasing their ownership interest in the Company to approximately 70.5% of the total number of common shares outstanding.

Increased capacity under revolving credit facility

In April 2008, the Company increased its revolving credit facility by \$25.0 million to a maximum \$115.0 million. In addition, the term of the facility was extended for an additional three-year period, to expire in April of 2011.

In support of the increased credit facility, Brookfield provided a guarantee of up to \$25.0 million of the Company's borrowings under the facility. The Company has agreed to pay a guarantee fee and to provide Brookfield with a fixed first charge over certain of the Company's property, plant and equipment while the guarantee is outstanding.

New Term Loan Facility

In June 2008, the Company entered into a CAD\$40.0 million secured loan arrangement with the province of New Brunswick to support the upgrade of Fraser Papers' facilities in the province.

The CAD\$40.0 million term loan can be drawn at any time before December 31, 2014 and is repayable over five years starting in March, 2010. The term loan is secured by a first charge on Fraser Papers' fixed assets in New Brunswick and bears interest at a fixed rate of 4.7%. Proceeds are targeted toward fixed asset upgrades in the province and included the modernization of the Plaster Rock, New Brunswick lumbermill and upgrades for the Edmundston, New Brunswick co-generation facility and sulphite pulp mill.

New Credit Facility

In September 2008, the Company secured a one-year, \$25.0 million term loan with a Canadian chartered bank. Proceeds of the loan were used to repay indebtedness under the Company's revolving credit facility.

In support of the credit facility, Brookfield provided a guarantee of the Company's borrowings under the facility. The Company has agreed to pay a guarantee fee and to provide Brookfield with a fixed first charge over certain of Fraser Papers' property, plant and equipment while the guarantee is outstanding.

East Papers Optimization

In 2007, the Company announced strategic initiatives at the East Papers operations to lower costs and continue to focus our manufacturing capability toward specialty papers with the permanent closure of two high cost freesheet paper machines at our Madawaska, Maine paper mill. These closures reduced the operating capacity of that mill by 70,000 tons or 15%. These closures were consistent with our strategy of focusing on value-added products and surpassing industry benchmarks for efficiency by transferring specialty freesheet to more efficient paper machines at the Madawaska facility.

As a result of the closures, the Company recorded a restructuring charge of \$15.9 million of which \$9.2 million is related to property, plant and equipment and spare parts inventory and other costs of \$6.7 million.

Sale of Acadian Timber Income Fund

During 2007, the Company sold its interest in Acadian Timber Income Fund ("Acadian") for proceeds of \$38.4 million. A gain of \$38.4 million was recorded on the sale.

Repayment of Senior Notes

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

KEY FACTORS AFFECTING OUR BUSINESS

Fraser Papers' operations and financial results are influenced by a number of factors, some of which we can control and some of which are outside of our control. A full discussion of the risks of the business is provided in the Company's Annual Information Form which is available at www.sedar.com.

Cyclical Business

In general, the Forest Products industry is highly cyclical characterized by periods of rising demand, supply shortages and rapidly rising market prices, leading to increased production and increased capital investment until new capacity and supply exceed demand. Those periods are then typically followed by periods of reduced market prices and excess capacity until the cycle is repeated.

Fraser Papers' strategy is to concentrate on products for which we can establish sustainable competitive advantage. We believe that, by concentrating on products that are related to high quality and extensive product qualification requirements, we lessen the threat of competitive substitution and benefit from certain barriers to market entry. By focusing our mix on value-added products with narrow technical specifications we also believe that we mitigate some of the cyclical risks. We accentuate our strengths by having small, flexible paper machines, by being a leader in developing high quality specialty packaging and paper grades and by providing superior customer and technical service. Our focus is to increase our market share in the specialty packaging and printing businesses such as those used in food packaging, labeling and financial printing.

Competitive Environment

The Forest Products industry is highly competitive. Our paper, pulp and lumber businesses compete directly with some of the leading manufacturers in the world. In order to differentiate Fraser Papers from our competition, we strive to provide excellent customer and technical service; focus on products which add value for our customers; and make products where we can leverage our unique manufacturing capabilities. Our sales force and technical service departments work very closely with our customers to ensure that Fraser Papers' products meet the customer's highly technical and operational needs and bring value to their process.

Product Demand

We have experienced decreased demand for some of our products as a result of electronic substitution. The growing use of electronic transmission and document storage alternatives has affected market demand for printing and writing papers. U.S. uncoated freesheet demand declined steadily from 2003 through 2008, reflecting the impact of electronic substitution, among other things. In addition, our pulp business must compete with an increasing supply of, and in some cases customer preference for, foreign sources of pulp such as eucalyptus pulps produced in Asia and South America. Our focus is to increase our market share in the specialty packaging and printing paper products and specialty pulp.

Declining product demand may cause us to temporarily shut down our mills if product prices fall to a level where mill operation would be uneconomical. Moreover, we may be required to temporarily suspend operations at one or more of our mills to bring production in line with market demand. During such temporary shutdowns, we may continue to expend capital to maintain the mill and equipment. We may also incur significant labour costs as a result of a temporary shutdown if we are required to give employees notice prior to any layoff or to pay severance for any extended layoff. Furthermore, temporary shutdowns may adversely affect our future access to skilled labour, as employees who are laid off may seek employment elsewhere. Given the costs involved in a temporary shutdown of our operations, we may instead choose to continue to operate those operations at a loss, which could have a material adverse effect on our financial position and results of operations.

Cost Control

Fraser Papers' cost structure is highly dependant upon securing competitive pricing and ensuring efficient usage of raw material and energy inputs. Changes in these cost inputs can have a material effect on our results. To help mitigate some of the cost pressures, we have long-term fibre supply contracts for wood, we have balanced our market pulp requirements with internal production capacity, we focus on reducing input consumption rates and, from time to time, we have hedged commodity prices.

Fraser Papers' margin improvement plan concentrates on the usage of raw materials and discretionary spending. In 2008, we created \$30.2 million of margin improvements compared to 2007 costs by focusing on improving our sales mix and energy optimization. We significantly reduced oil consumption which reduces our dependence on high cost oil.

Foreign Currency Risk

With 53% of Fraser Papers' property, plant and equipment located in Canada and essentially 100% of our sales denominated in U.S. dollars, we are exposed to fluctuations in foreign exchange rates. Changes in these exchange rates could have a material effect on our results of operations. To mitigate these effects, the Company hedges both cash flow and balance sheet exposure when appropriate.

RESULTS OF OPERATIONS AND RELATED INFORMATION

Financial Results

Net sales for 2008 were \$688.6 million, which was a decrease compared to the net sales of \$714.7 million in 2007 due to declining lumber markets and paper machine closures partially offset by improved pulp and paper revenues.

Loss for 2008 was \$71.9 million compared to a loss of \$43.1 million in 2007. This \$28.8 million decrease in relative performance was primarily as a result of a \$38.4 million pre-tax gain on the sale of Acadian and a \$13.4 million income tax recovery in 2007 partially offset by a \$15.9 million pre-tax restructuring charge in 2007 and \$8.3 million in improved EBITDA in 2008.

Summary financial data

<i>(US\$millions)</i>	Twelve months ended December 31	
	2008	2007 ⁽¹⁾
Net sales	\$ 688.6	\$ 714.7
EBITDA ⁽¹⁾	(33.6)	(41.9)
Pre-tax gain on sale of Acadian	—	38.4
Pre-tax restructuring charge	—	(15.9)
Income tax recovery	0.1	13.4
Earnings/(loss)	(71.9)	(43.1)

(1) Prior year's EBITDA adjusted for accounting change related to inventory (see "Changes in Accounting Policies").

The Company generated negative EBITDA of \$33.6 million in 2008 compared to negative EBITDA of \$41.9 million in 2007. The improved EBITDA in 2008 is from improved selling prices for paper and pulp, productivity improvements and cost reductions. However, paper and pulp markets at year-end 2008 were declining.

Summary results from operations

	Twelve months ended December 31	
	2008	2007 ⁽³⁾
Fraser Papers Inc.		
EBITDA ⁽¹⁾ (US\$millions)	(33.6)	(41.9)
Paper operations		
EBITDA ⁽¹⁾ (US\$millions)	(9.7)	(19.7)
Less: Impact of outages	(7.2)	(13.6)
Adjusted EBITDA ⁽²⁾	(2.5)	(6.1)
Adjusted EBITDA Margin (\$ per ton)	(4)	(10)
Adjusted Average Cash Cost ⁽¹⁾ (\$ per ton)	972	933
Pulp operations		
EBITDA ⁽¹⁾ (US\$millions)	(10.7)	(0.2)
Less: Impact of outages	(3.0)	(5.0)
Adjusted EBITDA ⁽²⁾	(7.7)	4.8
Adjusted EBITDA Margin (\$ per ton)	(37)	21
Adjusted Average Cash Cost ⁽¹⁾ (\$ per ton)	588	530
Lumber operations		
EBITDA ⁽¹⁾ (US\$millions)	(13.2)	(22.0)
EBITDA Margin (\$ per Mfbm)	(68)	(68)
Average Cash Cost ⁽¹⁾ (\$ per Mfbm)	312	342

(1) See "Definitions" section.

(2) Adjusted EBITDA has been adjusted for outages.

(3) Prior year's EBITDA adjusted for accounting change related to inventory (see "Changes in Accounting Policy").

Paper operations generated negative EBITDA of \$9.7 million compared to negative EBITDA of \$19.7 million in 2007. The 2008 and 2007 results included major planned outages at the Edmundston sulphite pulp mill and cogeneration facility as well as planned outages at the Madawaska and Gorham paper mills costing \$7.2 million in 2008 and \$13.6 million in 2007. After adjusting EBITDA for the outages, paper operations generated an EBITDA loss of \$2.5 million in 2008 and an EBITDA loss of \$6.1 million in 2007. Adjusted EBITDA improvement of \$3.6 million was due to improved revenue realization for paper shipments partially offset by higher energy prices and the effect of the stronger Canadian dollar.

Pulp operations generated negative EBITDA of \$10.7 million in 2008 compared to negative EBITDA of \$0.2 million in 2007. The 2008 results included an unscheduled maintenance outage at the Thurso pulp mill costing \$3.0 million. The 2007 results included a major planned maintenance outage at the Thurso pulp mill totaling \$5.0 million. After adjusting EBITDA for the outages, pulp operations generated an EBITDA loss of \$7.7 million in 2008 and EBITDA of \$4.8 million in 2007. The adjusted EBITDA decrease of \$12.5 million was due to higher energy prices, the effect of the stronger Canadian dollar and market-related downtime taken in the fourth quarter of 2008, partially offset by improved revenue realization for pulp shipments in the early part of 2008.

Lumber operations generated an EBITDA loss of \$13.2 million in 2008 compared to a loss of \$22.0 million in 2007. Significant downtime was taken at the lumber mills during 2008 to minimize operating losses while supporting the lowest cost option for providing woodchips to the Edmundston pulp mill.

Operating Results

Fraser Papers operates one business segment comprised of 11 paper machines at two locations, one market pulp facility, two internal pulp facilities and four lumbermills.

Products include paper (including specialty packaging and printing papers, commodity freesheet papers, specialty high-bright groundwood papers, commodity groundwood papers and towel), as well as hardwood pulp and softwood lumber.

Paper Operations

We own and operate a paper mill in Gorham, New Hampshire and an integrated pulp and paper facility in Edmundston, New Brunswick/Madawaska, Maine ("East Papers").

	Twelve months ended December 31	
	2008	2007 ⁽⁴⁾
Sales (US\$millions)	564.2	552.8
EBITDA (US\$millions) ⁽¹⁾	(9.7)	(19.7)
EBITDA (\$ per ton)	(17)	(34)
EBITDA margin ⁽²⁾	(2%)	(4%)
Shipments (000 tons)		
Specialty packaging	80	72
Specialty printing	205	234
Commodity freesheet papers	47	68
Specialty high-bright groundwood	131	97
Commodity groundwood	60	78
Towel	41	39
	564	588
Average Revenue Realized (\$ per ton)		
Specialty packaging	1,207	1,148
Specialty printing	1,050	987
Commodity freesheet papers	910	853
Specialty high-bright groundwood	889	859
Commodity groundwood	798	717
Towel	896	800
Weighted Average (\$ per ton)	985	922
Average Cash Operating Cost (\$ per ton)	985	956
Reference Prices (\$ per ton) ⁽³⁾		
50# offset rolls	912	832
22.1# white directory	750	740

(1) See "Definitions" section.

(2) EBITDA Margin is EBITDA as a percentage of Sales.

(3) Reference prices are from RISI, Inc. ("RISI").

(4) Prior year's EBITDA adjusted for accounting change related to inventory (see "Changes in Accounting Policies").

Our business strategy is to target market segments where we can achieve a meaningful or leadership position and where we can match our technical competencies with the demand for lightweight specialty freesheet and groundwood papers. In 2008, we had approximately 74% of our paper sales that fit this description, and the strategy is to transition the balance into new or existing specialty packaging, printing or groundwood products.

Average selling prices for pulp and paper increased in 2008 compared to 2007, however, pulp and paper markets weakened with the general economy in the fourth quarter of 2008. Fraser Papers took market-related downtime on paper machines to balance inventories against customer orders in December 2008 and January 2009. The market-related downtime was focused primarily on commodity products. We believe that over the longer term, the specialty nature of our paper products will help to position Fraser Papers better than many other companies in the paper industry.

Specialty packaging products are typically used for food applications and include both stain resistant and non-stain resistant qualities. Fraser Papers has the ability to meet narrow technical standards for applications such as pet food bags and dry mix consumer pouches and bags. With our focus on new products and applications, specialty packaging volumes increased by 8,000 tons over 2007. Specialty packaging pricing for 2008 increased by \$59 per ton compared to 2007 due to general market price increases and growth in the high value packaging segments.

Specialty printing papers include coated and uncoated freesheet products that are characterized by narrow technical

specifications and niche applications including labeling and thermal point-of-sale receipts as well as lightweight opaque grades for financial printing applications. Fraser Papers' specialty printing volumes were 205,000 tons in 2008 representing a decrease from 234,000 tons in 2007. A portion of the decrease was attributable to certain applications switching to our high-bright groundwood papers that offer better value and the balance reflects the permanent shutdown of 70,000 tons of capacity at East Papers in 2007. Fraser Papers' technical capabilities, which provide the opportunity to manufacture both freesheet and groundwood papers from the same facility, have allowed us to assist our customer base in this transition.

We continue to narrow our focus toward higher margin specialty packaging and printing paper products in strategic markets. For 2008, commodity freesheet volume, which represents only 8% of total shipments, has decreased by 31% compared to 2007.

Specialty high-bright groundwood papers include products that are used for financial printing and other publishing applications where high performance and superior print quality are required. In 2008, specialty high-bright groundwood shipments were 131,000 tons which is a 35% increase from 2007 shipments of 97,000 tons. This increase is indicative of certain applications migrating from freesheet products to high-bright groundwood products and new product applications.

Compared with 2007, Fraser Papers' shipments of commodity groundwood products in 2008 decreased by 18,000 tons as we increased the volumes of specialty high-bright groundwood grades.

Twelve months ended December 31, 2008 compared to twelve months ended December 31, 2007

In 2008, the paper operations had negative EBITDA of \$9.7 million on sales of \$564.2 million. This compares to negative EBITDA of \$19.7 million in 2007 on sales of \$552.8 million. Adjusting for the major planned maintenance outages in 2008 of \$7.2 million, the paper operations generated negative EBITDA of \$2.5 million in 2008. Adjusting for the major outages in 2007 of \$13.6 million, the paper operations generated negative EBITDA of \$6.1 million in 2007. The \$3.6 million increase in adjusted EBITDA was due to higher mill net realizations, increased internal pulp and paper productivity and reduced energy consumption.

Shipments in 2008 were 24,000 tons lower than last year as improved paper machine productivity partially offset the capacity closures equivalent to 70,000 of annual production.

Pulp Operations

We own and operate a NBHK market pulp mill in Thurso, Quebec.

	Twelve months ended December 31	
	2008	2007
Sales (US\$millions)	75.0	72.9
EBITDA (US\$millions) ⁽¹⁾	(10.7)	(0.2)
Pulp EBITDA (\$ per tonne)	(51)	(1)
EBITDA Margin ⁽²⁾	(14%)	0%
Shipments (000 tonnes) ⁽³⁾	209	234
Average Revenue Realized (\$ per tonne) ⁽³⁾	584	555
Average Cash Operating Costs (\$ per tonne)	602	551
Reference Price (\$ per tonne) ⁽⁴⁾		
NBHK market pulp	788	719

(1) See "Definitions" section.

(2) EBITDA Margin is EBITDA as a percentage of Sales.

(3) Pulp volumes and average revenues realized include internal sales.

(4) Reference prices are from RISI's Pulp & Paper Week.

The pulp market experienced some dramatic swings during 2008. World pulp demand grew by 4% in the first half of 2008; however, due to the slowing economy, demand in the second half of 2008 declined by 9%. As a result, hardwood pulp inventories grew to 60 days compared to 35 days which indicate a balanced market. For the year, the average benchmark price increased \$69 per tonne to \$788 per tonne; however, the December benchmark price declined to \$665 per tonne.

We direct a portion of our market pulp for internal use. Fraser Papers also purchases softwood kraft pulp from third parties to supplement internal production. With improved internal pulp production at the Edmundston pulp mill in 2008, net pulp sales amounted to 52,000 tonnes for the year.

Twelve months ended December 31, 2008 compared to twelve months ended December 31, 2007

The pulp operations generated negative EBITDA of \$10.7 million in 2008 on sales of \$75.0 million. This compares to the previous year's negative EBITDA of \$0.2 million on sales of \$72.9 million. Revenues increased by \$2.1 million due to higher average pricing with the full year benchmark pricing higher by 10%. The EBITDA decrease of \$10.5 million is primarily due to cash costs increasing 9% to \$602 per tonne compared to \$551 per tonne in 2007. Increased oil pricing and wood fibre costs, the effect of the stronger Canadian dollar and the unplanned and market-related downtime were partially offset by lower oil consumption.

Shipments declined by 25,000 tonnes primarily from the poor pulp market conditions experienced in the second half of 2008 and market-related downtime.

Lumber Operations

Our lumber operations are comprised of four lumbermills located in Plaster Rock, New Brunswick; Juniper, New Brunswick; Ashland, Maine; and Masardis, Maine.

	Twelve months ended December 31	
	2008	2007
Sales (US\$millions)	49.4	89.0
EBITDA (US\$millions) ⁽¹⁾	(13.2)	(22.0)
EBITDA (\$ per Mfbm)	(68)	(68)
EBITDA Margin ⁽³⁾	(27%)	(25%)
Shipments (MMfbm)	193	324
Average Revenue Realized (\$ per Mfbm)	252	273
Average Cash Operating Cost (\$ per Mfbm)	312	342
Reference Price (\$ per Mfbm) ⁽²⁾		
Boston SPF 2X4 #2&Btr	301	324

(1) See "Definitions" section.

(2) Reference prices are from Random Lengths.

(3) EBITDA Margin is EBITDA as a percentage of Sales.

Market conditions deteriorated significantly for our lumber operations during 2008. Average benchmark lumber prices (Eastern Boston SPF 2X4) decreased 7% or \$23 per Mfbm from 2007. Consequently, the Company's net revenue realized decreased 8% compared to 2007 with the continued softness in U.S. housing activity where annual construction starts have fallen from their peak of an annualized 2.3 million in January 2006 to an annualized 0.55 million in December 2008; a 76% decline.

In 2008, we took market-related downtime at all of our lumbermills: 46 weeks at Ashland, Maine; 37 weeks at Juniper, New Brunswick; 25 weeks at Plaster Rock, New Brunswick and one week at Masardis, Maine. This equates to a total of 110 weeks of lumbermill market downtime in 2008. The lumber business operated at 44% of capacity in 2008.

In 2007, we also took market-related downtime at all of our lumbermills: 11 weeks at Ashland, Maine; 22 weeks at Juniper, New Brunswick; 20 weeks at Plaster Rock, New Brunswick and two weeks at Masardis, Maine. This equates to a total of 54 weeks of lumbermill market downtime in 2007. The lumber business operated at 69% of capacity in 2007.

We continue to evaluate our lumbermill operating schedule in reference to the availability of cost effective woodchips for our pulp operations in Edmundston, New Brunswick.

Twelve months ended December 31, 2008 compared to twelve months ended December 31, 2007

The lumber operations generated negative EBITDA of \$13.2 million in 2008 on sales of \$49.4 million. This compared to negative EBITDA of \$22.0 million in 2007 on sales of \$89.0 million. Weak market conditions (with benchmark prices reduced by 7%) and lower selling prices continued; however, cash costs have been reduced by \$30 per Mfbm.

Shipments declined by 40% in 2008, compared to 2007, due to market-related downtime.

CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES

The preparation of financial statements in accordance 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.

The restructuring charge booked against the assets of the two paper machines permanently closed in 2007 was based on significant estimates due to the inherent uncertainty in net recoverable amounts we will receive when we sell those assets. Also, the provision for liabilities associated with the Smart Papers restructuring in 2006 was based on estimates of future cash flows under a most likely scenario. Future events may differ from the most likely scenario used by the Company.

From time to time, Fraser Papers will review the carrying value of long-lived assets to determine whether the carrying value of those assets is appropriate. Significant estimates are used in determining the expected future cash flows associated with those assets. While those cash flows are determined using reasonable assumptions, those cash flows are subject to future events and circumstances which could differ materially from management's estimate of those cash flows.

Revenue recognition

Net sales are net of freight costs, commissions, discounts and rebates and are recognized when the title and risks of ownership pass to the purchaser. This generally occurs when goods are shipped. Sales are governed by contract or by standard industry terms. Revenue is not recognized prior to the completion of those terms. The majority of product is shipped via third party transport on an FOB shipping basis. In all cases, product is subject to quality testing to ensure it meets applicable standards prior to shipment.

Inventories

Inventories of raw materials and operating and maintenance supplies are valued at the lower of cost and net realizable value, with cost determined on an average cost basis.

Inventories of finished goods are valued at the lower of cost and net realizable value, with cost determined on an average cost basis. Cost includes direct material, direct labour and an allocation of overhead.

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

These periods are regularly assessed to ensure that they continue to approximate the useful lives of the related assets.

Financial Instruments

The Company uses derivative financial instruments solely for the purpose of managing foreign exchange and commodity price exposures. These activities are governed by the Board of Directors' approved financial policies that cover risk identification, measurement and reporting. Derivative transactions are executed only with approved counterparties under master netting agreements. Derivative contracts, which are deemed to be highly effective in offsetting changes in the fair value or cash flows of hedged items, are designated as hedges of specific exposures and accordingly, all gains and losses on these instruments are recognized in the same manner as the item being hedged.

Future Income Taxes

Future income tax assets and liabilities are determined based on temporary differences between the carrying amount and tax basis of assets and liabilities as well as certain carry-forward items. Future income tax assets are recognized only to the extent that, in the Company's opinion, it is more likely than not that the future income tax assets will be realized. This opinion is based on certain estimates and assumptions. If these estimates or assumptions change in the future, the Company could be required to reduce or increase the value of the future income tax assets resulting in income tax expense or recovery. The Company evaluates its future income tax assets periodically.

Defined Benefit Pension Plans

Fraser Papers' defined benefit pension plans are funded in accordance with all applicable regulatory requirements. Fraser Papers' obligations under our defined benefit pension plans are determined periodically through actuarial valuations, which are the basis for calculating pension expense. The weighted average assumed return on assets is 8.00% and is based on management's best estimate of the long-term expected rate of return on plan assets, including consideration of asset mix, equity risk premium and active investment management premium. The weighted average discount rate used to value year-end 2008 accrued benefit obligations is 6.18% and is based on the market yield of high-quality corporate bonds of similar duration to the pension plan liabilities.

Significant changes in assumptions, driven by changes in financial markets, asset performance different from the assumed rate of return, significant new plan enhancements, acquisitions, divestitures, changes in the regulatory environment, and the measurement uncertainty incorporated into the actuarial valuation process could materially affect Fraser Papers' future plan assets, accrued benefit obligations, pension expense and pension contributions.

Stock-Based Compensation

The Company accounts for stock options using the fair value method. Under this method, compensation expense for options is measured at the grant date using the Black-Scholes option pricing model based on certain estimates and assumptions and is recognized on a straight-line basis over the vesting period. If estimates or assumptions change in the future, the Company could be required to reduce or increase contributed surplus, resulting in compensation expense or recovery.

CHANGES IN ACCOUNTING POLICIES

On January 1, 2008, the Company adopted new recommendations of the Canadian Institute of Chartered Accountants ("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, the Company 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 resulted in an increase to property, plant and equipment of \$3.2 million, a decrease in inventories of \$0.7 million, an increase in future income tax liabilities of \$0.4 million and a decrease in opening deficit as at January 1, 2007 of \$2.1 million. In addition, the Company has restated its 2007 results of operations in order to reflect this change in policy. These adjustments resulted in a reduction in the consolidated loss of \$2.7 million and \$0.6 million for 2008 and 2007 respectively, compared to if the Company had not changed its policy.

International Financial Reporting Standards

The Accounting Standard Standards Board ("AcSB") confirmed in February 2008 that Canadian public companies will adopt International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). IFRS will replace Canadian GAAP for publicly accountable enterprises for financial periods beginning on and after January 1, 2011. Early adoption is permissible. The Company is currently assessing the impact and date it intends to adopt IFRS.

Impact of Adoption of IFRS

IFRS are premised on a conceptual framework similar to Canadian GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. As the Company continues to evaluate the impact of adoption of IFRS on its processes and accounting policies, updated disclosure will be provided where appropriate. While the adoption of IFRS will not have a material impact on the reported cash flows of the Company, it is expected to have a material impact on the Company's consolidated balance sheets and consolidated statements of operations and deficit.

Property, Plant and Equipment

Under International Accounting Standard ("IAS") 16 *Property, Plant and Equipment*, an entity is required to account for each class of property, plant and equipment using either the cost model or the revaluation model. The cost model is generally consistent with Canadian GAAP where an item of property, plant and equipment is carried at its original cost, less accumulated depreciation and accumulated impairment losses. Under the revaluation model, each item of property, plant and equipment is revalued on a periodic basis and carried at its revalued amount, less any accumulated depreciation and accumulated impairment losses.

Impairments

Under Canadian GAAP, for assets other than financial assets, a write-down to estimated fair value is recognized if the estimated undiscounted future cash flows from an asset or group of assets are less than their carrying value. Under IAS 36, *Impairment of Assets*, assets must be written down to their recoverable amount, (determined as the higher of a) the estimated fair value less costs to sell or b) value in use), if the recoverable amount is less than the carrying value. Unlike Canadian GAAP, IAS 36 requires the reversal of an impairment loss where the recoverable amount exceeds the previously written down carrying value.

Employee Benefits Plans

Under Canadian GAAP, actuarial gains and losses on employee benefit plans are deferred and amortized over the expected average remaining service life ("EARSL") of the employee group. In addition, accrued pension benefit obligations and plan assets for defined benefit pension plans are required to be disclosed in the notes to the consolidated financial statements. Under IAS 19, *Employee Benefits*, on transition to IFRS, an entity may elect to recognize the obligation in excess of plan assets on the balance sheet as a liability, recognizing unamortized actuarial gains or losses directly in equity. Future actuarial gains and losses could be recorded as a direct charge to equity or amortized over EARSL.

Share-Based Payment

The Company issues stock-based awards in the form of stock options that vest evenly over a five-year period. Under Canadian GAAP, the Company recognizes the fair value of the award, determined at the time of the grant, on a straight-line basis over the five-year vesting period. Under IAS 19, the fair value of each option is determined with respect to when it vests as well as when it is issued. As such, the fair value of each vested tranche is considered a separate option grant. The expense associated with each grant is recognized as compensation expense over the term of its respective vesting period. Accordingly, this will result in a faster recognition of the cost of each option issuance than under Canadian GAAP.

First-time Adoption of International Financial Reporting Standards

IFRS 1, *First-time Adoption of International Financial Reporting Standards*, provides guidance for the initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS standards effective at the end of its first IFRS reporting period retrospectively. However, IFRS 1 does require certain mandatory exceptions and limited optional exemptions in specified areas of certain standards from this general requirement. The Company is currently evaluating the exceptions and exemptions under IFRS 1 and will provide updated disclosure when available.

LIQUIDITY AND CAPITAL RESOURCES

(US\$millions)	Twelve months ended December 31	
	2008	2007
Cash flow from operating activities before changes in working capital	(55.5)	(65.4)
Cash flow from operating activities after changes in working capital	(45.9)	(48.2)
Total working capital ⁽¹⁾	115.4	116.9
Capital investments	27.1	20.3
Net debt	96.4	85.9
Net debt to net debt plus equity	25%	23%
Maximum borrowings under revolving credit facility	115.0	140.0
Revolving credit facility utilized	86.7	123.9

(1) Total working capital includes accounts receivable, inventory and accounts payable and accrued liabilities.

Operating Cash Flows

During 2008, cash flow from operations before changes in working capital was an outflow of \$55.5 million compared to an outflow of \$65.4 million during 2007. The \$9.9 million decrease was primarily the result of improved EBITDA and reduced employment benefit plan funding (see "Employee Benefit Plans").

During 2008, net change in non-cash working capital was an inflow of \$9.6 million compared to an inflow of \$17.2 million during 2007. Accounts receivable were reduced in 2008 by \$31.2 million compared to a decrease of \$7.1 million in 2007. The reduced accounts receivable were due to increased collection efforts and lower paper and pulp sales in the fourth quarter of 2008. On January 29, 2009 the Company announced the sale of approximately 10,500 tons of finished goods paper inventory to Brookfield for proceeds of approximately \$11.7 million. 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 customary merchant's discount of 3.5%. Fraser Papers will provide sales and administrative support to Brookfield. Accounts payable in 2008 decreased by \$28.4 million compared to an increase of \$20.1 million in 2007 as a result of maintenance outages and market-related downtime in December 2008.

The Company's ability to generate positive future cash flows is dependent upon many factors including market pricing for our products. Fraser Papers continues to focus on initiatives that will reduce fixed costs, improve efficiencies and optimize the use of raw materials. We have also increased the selling price for certain of our products during 2008. We believe these initiatives will position Fraser Papers to benefit as costs return to historic levels resulting in improved operating cash flows.

Investing Cash Flows

For 2008, capital investments totaled \$27.1 million compared to \$20.3 million in 2007. During 2008, investments were made: in the Edmundston sulphite pulp mill, cogeneration facility and recovery boiler; in the modernization of the Plaster Rock, New Brunswick lumbermill; and, to address productivity issues at the Edmundston sulphite pulp mill. Capital investments in 2007 included the planned rebuild of the recovery boiler at the Edmundston pulp facility. Funding for these capital expenditures was supported primarily from available liquidity sources (see "Financing Cash Flows").

In 2008, a CAD\$17.5 million capital investment for the modernization of our Plaster Rock, New Brunswick lumbermill was announced that will include the installation of a biomass boiler and upgrades to the lumbermill's sawing and kiln equipment. Spending on the project in 2008 was CAD\$2.8 million for major equipment procurement. The remaining investment will occur in 2009 with the expected completion in the summer of 2009. Funding for this project will be supported primarily from available liquidity sources, including a term loan facility with the province of New Brunswick (see "Financing Cash Flows").

Financing Cash Flows

Liquidity requirements in 2008 to fund maturing debt and negative free cash flow were provided from a rights offering, an increase in the Company's revolving credit facility and a \$25.0 million term credit facility. Each of these facilities was strongly supported by the Company's largest shareholder. Additionally, the Company secured CAD\$20.0 million in borrowings under the term loan facility with the province of New Brunswick.

In January 2008, the Company completed a rights offering and issuance of common shares to its shareholders (the "Offering"). Under the Offering, the Company issued 20,656,913 common shares for aggregate proceeds of \$59.7 million. Common shares outstanding at the conclusion of the Offering were 50,166,789. The net proceeds from the Offering were used to repay drawings under the Company's credit facility.

In April 2008, the Company increased its revolving credit facility by \$25.0 million to a maximum \$115.0 million. In addition, the term of the facility was extended for an additional three-year period, to expire in April of 2011. In support of the increased credit facility, Brookfield provided a guarantee of up to \$25.0 million of the Company's borrowings under the facility. The Company has agreed to pay a guarantee fee and to provide Brookfield with a fixed first charge over certain of Fraser Papers' property, plant and equipment while the guarantee is outstanding.

Total borrowings under the revolving credit facility at December 31, 2008 were \$48.2 million. In addition, the Company had utilized \$38.5 million of the facility in support of letters of credit.

In September, 2008, the Company secured a one-year, \$25.0 million term loan with a Canadian chartered bank. Proceeds of the loan were used to repay indebtedness under the Company's revolving credit facility. In support of the credit facility, Brookfield provided a guarantee of the Company's borrowings under the facility. The Company has agreed to pay a guarantee fee and to provide Brookfield with a fixed first charge over certain of Fraser Papers' property, plant and equipment while the guarantee is outstanding.

In June 2008, the Company entered into a CAD\$40 million secured loan arrangement with the province of New Brunswick to support the upgrade of Fraser Papers' facilities in the province. The CAD\$40 million term loan can be drawn at any time before December 31, 2014 and is repayable over five years starting in March, 2010. The term loan is secured by a first charge on Fraser Papers' fixed assets in New Brunswick and bears interest at a fixed rate of 4.7%. Proceeds are targeted towards fixed asset upgrades in the province and included the modernization of the Plaster Rock, New Brunswick lumbermill and upgrades to the Edmundston, New Brunswick co-generation facility and sulphite pulp mill.

Net debt as of December 31, 2008 was \$96.4 million, resulting in a net debt to net debt plus equity ratio of 25%. The Company believes that its conservative capital structure is appropriate given the long lives of its productive assets. The Company currently has debt of \$25.0 million which is due in September, 2009. The Company is exploring its options with respect to re-financing this debt maturity which include additional issuances of debt and/or equity capital. Fraser Papers is dependent upon the continued support of Brookfield to support certain of its long term debt obligations, including Brookfield's guarantee of debt maturing in 2009.

Seasonal Cash Flow Requirements

Quarterly results are affected by certain seasonal factors such as market demand and the impact of weather on logging activities.

Market demand varies seasonally for certain products such as financial printing papers. The peak of the financial printing season is in the first and second quarters of the year. Since shipping volume during the peak financial season exceeds our production capacity in certain grades, we build inventory prior to the financial printing season in order to supply our customers' needs. The build of financial printing paper inventory will have a negative effect on cash flows from operations after changes in working capital in the quarter of inventory build, but will have a positive effect in the quarter of inventory reduction.

Weather causes seasonal variation in certain raw materials. During spring, seasonal rainfall creates poor ground conditions in the timberlands which reduce logging activities. In anticipation of this mud season each spring, Fraser Papers will build log inventories to provide adequate supply of fibre until ground conditions improve. The build of inventory will have a negative effect on cash flows from operations after changes in working capital but will have a positive effect in the quarter of inventory reduction.

EMPLOYEE BENEFIT PLANS

Fraser Papers has five registered pension plans in three jurisdictions: two plans in the province of New Brunswick, two plans in the province of Quebec and one plan in the United States. In 2008, we filed actuarial valuations for the two plans in New Brunswick and the plan in the United States. In 2009, we are required to file actuarial valuations for one plan in New Brunswick and the plan in the United States. The two plans in the province of Quebec require an actuarial filing no later than December 31, 2009 although the province may require an actuarial valuation at their discretion. The second registered pension plan in the province of New Brunswick requires an actuarial filing no later than December 31, 2010. Pension regulators in various jurisdictions are considering a number of changes to their pension filing and funding requirements as a result of the significant reductions in pension asset values over the past number of months. The impact of these possible changes on the pension plan funding requirements has not been determined at this time.

Fraser Papers' obligations under our defined benefit pension plans are determined periodically through actuarial valuations, which are the basis for calculating pension expense and determining pension funding. At December 31, 2008, the value of pension plan assets was \$337.3 million, down from \$530.5 million in 2007. Significant declines in capital markets and foreign exchange impact of translating the assets of our Canadian plans into United States dollars accounted for the reduction. The 2008 weighted average rate of return on our defined benefit pension plan assets was negative 21.5%. The weighted average asset allocation of our defined benefit pension plans is 64% equity investments and 36% fixed income investments. The accrued benefit obligation of these plans also fell from \$643.0 million in 2007 to \$508.8 million in 2008. The main reasons were an increase in the discount rate used to discount the obligation and foreign exchange translation.

For 2008, employee benefit plans funding was \$26.0 million, a decrease of \$5.2 million from the 2007 funding level of \$31.2 million. The decreased funding is primarily due to the impact of a one-time, retroactive payment of \$4.2 million in 2007. Fraser Papers has applied for funding relief under current pension regulations in New Brunswick. If we are successful in our application, future funding requirements for certain pension plans could be lower.

Benefit plan expense for 2008 was \$15.2 million compared to the \$13.5 million expense in 2007. The increase is due to a settlement expense of \$1.3 million related to the partial wind-up of a pension plan related to the sale of our New Brunswick timberlands in 2006.

The assumed return on our pension assets is 8.00% and is based on management's best estimate of the long-term expected rate of return, including consideration of asset mix, equity risk premium and active investment management premium. The weighted-average discount rate for the accrued benefit obligations is 6.18% as compared to 5.42% in 2007 and is based on the market yield of high quality corporate bonds of similar duration to the pension plan liabilities.

Significant changes in assumptions, driven by changes in financial markets, asset performance different from the assumed rate of return, benefit changes, acquisitions, divestitures, changes in the regulatory environment, and the measurement uncertainty incorporated into the actuarial valuation process, could materially affect our future plan assets, accrued benefit obligations, and the expenses and contributions associated with our employee benefit plans.

Sensitivity to a 1% increase or decrease in the rate of return on plan assets and the discount rate used to determine our pension obligations is estimated as follows:

	Impact Dec. 31, 2008 Unfunded Liability	Impact on 2008 Pension Expense
Return on assets	\$3.4 million	\$3.4 million
Discount rate	\$55.8 million	\$4.7 million

Our obligations under post-retirement benefit plans are determined periodically through actuarial valuations, which are the basis for calculating post-retirement benefit expense. We fund these plans on a "pay-as-you-go" basis. At December 31, 2008, the accrued benefit obligations of these plans were \$46.8 million compared to \$60.7 million at the end of 2007.

Recent changes in world equity markets and borrowing rates will affect the funded status, funding requirements and pension expense associated with Fraser Papers' defined benefit pension plans. Based on current pension regulations in Quebec, New Brunswick and in the United States, we expect our employee defined benefit plans expense in 2009 will increase by approximately \$13.8 million to \$29.0 million and our employee defined benefit plan funding will increase by approximately \$4.6 million to \$30.6 million as a result of losses in pension assets and no gain from the discount rate.

CONTRACTUAL OBLIGATIONS

The following table presents the total contractual obligations, including purchase obligations which are enforceable and legally binding and employee benefit obligations as of December 31, 2008:

<i>(US\$millions)</i>	Total	Less than one year	One to three years	Four to five years	After five years
Debt	\$ 89.5	\$ 25.0	\$ 51.9	\$ 12.6	\$ —
Operating leases	1.0	0.4	0.5	0.1	—
Purchase obligations	21.8	21.8	—	—	—
Employee benefit obligations	218.3	30.8	77.1	48.9	61.5
Total contractual obligations	\$ 330.6	\$ 78.0	\$ 129.5	\$ 61.6	\$ 61.5

Obligations under operating leases include future payments for office facilities and equipment leases. The purchase obligations are commitments for the purchase of energy and chemical supplies. Employee benefit obligations are accrued defined benefit pension plan and post-retirement benefit plans obligations, in excess of defined benefit pension plan assets.

Brookfield has provided guarantees to the Company's lenders in support of its revolving credit facility and one-year term loan. The maximum amount of the guarantees is \$50.0 million. The Company agreed to pay Brookfield a guarantee fee equal to an annualized rate of approximately 2.0% of the maximum amount of the guarantee and provided Brookfield with a guarantee that it will repay Brookfield any amounts paid by Brookfield to the Company's lenders. As security, the Company has provided Brookfield with a fixed charge on certain of its property, plant and equipment.

Norbord Inc. (the former parent company of Fraser Papers) has provided guarantees for certain obligations of Fraser Papers under a financial commitments agreement. At December 31, 2008, the maximum potential amount of the obligations guaranteed was estimated to be \$1.0 million. These obligations will be fully repaid during the first quarter of 2009. These guarantees have not been included in the table above.

HEDGING ACTIVITIES

From time to time, the Company enters into arrangements to fix the future price for certain products or to fix the exchange rate on certain of its Canadian dollar-denominated cash flows.

As of December 31, 2008, the Company had \$41.0 million in foreign exchange contracts outstanding as fair value hedges against certain Canadian dollar-denominated net monetary liabilities. For 2008, the Company realized \$7.6 million of losses on these contracts and at December 31, 2008, there were \$0.1 million in unrealized losses on these contracts. The gains or losses on fair value hedges are offset by net losses or net gains on the net liabilities being hedged.

As of December 31, 2008, the Company had \$91.5 million in net forward foreign exchange contracts outstanding as a hedge against future net Canadian dollar cash flows. These contracts have varying maturity dates in 2009. During 2008, the Company realized \$4.0 million of losses related to foreign exchange contracts used to hedge Canadian dollar cash flows. At December 31, 2008, the unrealized gains on outstanding contracts amounted to \$3.4 million. After giving effect to the realized losses on these hedges, the average realized exchange rate for 2008 was CAD\$1.00 = US\$0.95 compared to the published average rate of CAD\$1.00 = US\$0.94.

Realized and unrealized gains or losses on Canadian dollar-denominated net liabilities hedges and realized gains or losses on cash flow hedges are recorded in the consolidated statements of operations and deficit, in the same manner as the realized and unrealized gains or losses on the net monetary liabilities and realized gains or losses on cash flows being hedged. Unrealized gains or losses on cash flow hedges are recorded in consolidated statements of other comprehensive income until such time that the Canadian dollar-denominated cash flows being hedged are realized.

Fraser Papers enters into lumber forward contracts to fix the lumber price for a portion of its future production. During 2008, Fraser Papers entered into lumber futures contracts representing 30.8 million board feet of lumber. Some of these contracts were realized in 2008, while others mature in the first quarter of 2009. Accordingly, a realized gain of \$0.7 million has been reported in the consolidated statements of operations for the twelve month period ended December 31, 2008. Unrealized gains of \$0.7 million were recognized in other comprehensive income for the twelve months ended December 31, 2008.

TAXATION MATTERS

As at December 31, 2008, Fraser Papers had tax loss carry-forwards of \$326.4 million in the U.S. and \$71.7 million in Canada. These tax loss carry-forwards expire between 2014 and 2028 and are available to reduce income taxes otherwise payable in future years. The Company has recorded a valuation allowance against the tax loss carry-forwards in the U.S. to the extent that it is not more likely than not that the benefit of the losses will be realized.

In 2007, Brookfield increased its ownership interest in the Company from 49.3% to 56.1%, resulting in an acquisition of control as determined under Canadian income tax laws. Subsequently, Brookfield has increased its ownership interest to approximately 70.5%. The acquisition of control requires that the Company recognize certain unrealized losses for income tax purposes. As a result of recognizing these losses and applying them to prior years in 2007, the Company increased its available non-capital loss carry-forwards in Canada by \$46.8 million and recorded an income tax recovery of \$13.8 million.

ASSET RETIREMENT OBLIGATIONS

Asset retirement obligations relate primarily to closure costs and post-closure maintenance costs for landfills. The liability is reflected in other liabilities on our consolidated balance sheet at the discounted value of expected future cash flows. The liability associated with these obligations 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. The obligations represent estimated future payments of \$28.2 million which have been discounted at a weighted average rate of 8.0%. Total expense for the year related to asset retirement obligations was \$0.8 million compared to \$0.7 million in 2007. In addition to the asset retirement obligations recorded, we may have other obligations in the event of a permanent plant shutdown. However, our plant assets have indeterminate lives and, therefore, the associated asset retirement obligations are not reasonably estimable and liabilities cannot be established.

OFF-BALANCE SHEET ARRANGEMENTS

We have no material off-balance sheet arrangements.

COMMON SHARES

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 for 2008, an increase of 18,935,504 shares compared to 2007 as a result of the rights offering.

Common share information	December 31, 2008	December 31, 2007
Shares outstanding	50,166,789	29,509,876
Book value	\$5.67	\$9.83
Market price at year-end	CAD\$0.33	CAD\$2.68
Market price at February 5, 2009	CAD\$0.33	

In 2008, the Company issued 20,656,913 shares at a purchase price of CAD\$2.90 per share and received net proceeds of \$59.7 million.

DIVIDENDS

The Company paid no dividends in 2008. The Board of Directors reviews this policy at each of its regularly scheduled meetings.

STOCK BASED COMPENSATION

We account for stock options using the fair value method. Under this method, compensation expense for options is measured at the grant date using an option pricing model and recognized on a straight-line basis over the vesting period. During 2008, the Board of Directors approved the issuance to certain executives of 1,445,000 options with a strike price of CAD\$3.01. During 2007, the Board of Directors approved the issuance to certain executives of 1,015,000 options with a strike price of CAD\$5.99. In 2008 we recognized \$1.2 million in expense related to stock options compared to \$0.9 million in 2007.

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 share units. Deferred share units may be subject to vesting periods. Payments under the plans are made in cash only. The total number of deferred share units outstanding at December 31, 2008 was 666,168. During the year, the Company's obligation under these plans was reduced by \$0.8 million, as the impact of the decline in the Company's share price was greater than the amortized expense of the deferred share units.

TRANSACTIONS WITH RELATED PARTIES

Fraser Papers purchased \$4.8 million of electricity for its Gorham paper mill from Brookfield and its affiliates in 2008, compared to \$5.7 million in 2007.

Fraser Papers has invested in convertible, term, 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 million.

During the year, Fraser Papers sold \$1.7 million of goods and services to Katahdin and earned a management fee of \$7.5 million. In 2007, Fraser Papers sold \$3.3 million of goods and services to Katahdin and earned a management fee of \$8.0 million.

The Company entered into a 20 year Fibre Supply Agreement with Acadian. Fibre purchases from Acadian during 2008 were \$26.1 million compared to \$33.6 million in 2007. The Company paid \$1.5 million to Acadian as a fee for administering the Company's Crown Licenses. The Company sold its interest in Acadian on September 26, 2007. Of the 3,613,780 units sold, 2,600,000 were sold to Brookfield for net proceeds of \$27.6 million. During 2007, the Company recognized equity in earnings of Acadian of \$2.3 million and distributions received were \$2.3 million.

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 million. 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, the Company 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 million 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 million 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 million as a hedge against certain Canadian dollar-denominated net monetary liabilities, compared to \$30.2 million in 2007. In addition, the Company holds \$100.3 million under this facility as a hedge against future Canadian dollar cash flows, compared to \$35.2 million in 2007.

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

Fraser Papers is dependant on the continued financial support of Brookfield. Without this support, it is possible that we may not be able to secure alternative sources of financing with terms that are satisfactory to us.

MARKET RISKS AND UNCERTAINTIES

Many of Fraser Papers' raw material inputs and supplies are purchased on the open market and as such are subject to market price fluctuations. With the recent reductions in the prices for global commodities, we expect to benefit from these reductions. In particular, Fraser Papers consumes approximately 480,000 barrels of oil per year and purchases approximately 71,000 tonnes of market pulp per year.

Approximately 53% of Fraser Papers' assets are located in Canada while essentially 100% of the sales are U.S. dollar-denominated. Fraser Papers incurs approximately CAD\$360 million per year of Canadian dollar-denominated expenses, and we expect to benefit from the recent weakening of the Canadian currency.

Recent events in world capital markets have made it difficult for many companies to obtain or renew debt financing. Without the continued support of Brookfield, there can be no certainty that Fraser Papers will be able to secure alternative sources of financing with terms that are satisfactory to us.

We are exposed to a number of risks in the normal course of our business that have the potential to affect our operating performance.

Commodity and Price Sensitivity

Our earnings are sensitive to changes in world economic conditions, primarily in North America. Paper, pulp and lumber markets are competitive in nature and prices for many products are sensitive to variations in supply and demand.

Based on the operating levels in 2008, the following table shows the approximate annualized impact on after tax earnings of changes in product prices.

	Sensitivity Factor	Impact on Earnings (US\$millions)	Impact on EBITDA (US\$millions)	Average Mill Nets Q4, 2008
Uncoated freesheet	\$25 per ton	\$ 5.4	\$ 8.3	\$ 1,114
Groundwood paper	\$25 per ton	3.1	4.8	879
Market pulp	\$25 per tonne	0.9	1.4	491
Lumber	\$10 per Mfbm	1.3	1.9	227

Competition

The forest products industry is a highly competitive business environment in which companies compete, to a large degree, on the basis of price. Our principal market is in the U.S. where we compete with North American and, in some instances, foreign producers. Certain competitors may have lower cost facilities than us. Our ability to compete in these and other markets is dependent on a variety of factors such as manufacturing costs, continued free access to markets, customer service, product quality, and currency exchange rates.

Foreign Exchange

We compete within North American markets where product prices are significantly influenced by U.S. dollar exchange rates.

Our foreign exchange exposure arises from the following sources:

- Net Canadian dollar-denominated monetary assets and liabilities.
- Committed or anticipated foreign currency transactions, primarily Canadian dollar costs in our Canadian operations.

The Company's policy is to hedge all significant balance sheet foreign exchange exposures. The Company may hedge a portion of net Canadian dollar-denominated cash flows for periods up to three years in order to reduce the volatility of future Canadian dollar-denominated cash flows. In 2008, we were negatively impacted by the continued strengthening of the Canadian dollar, with an effective average exchange rate, (after giving effect to the Company's hedging program) relative to the U.S. dollar, of US\$0.95 compared to US\$0.93 in 2007 on our approximately CAD\$360 million net Canadian dollar cash flows. We estimate that each U.S. one cent change in the value of the Canadian dollar would have impacted annualized pre-tax losses by approximately \$3.6 million in 2008.

Defined Benefit Pension Plans

Fraser Papers has defined benefit pension plans that are valued based on rate of return and discount rate market assumptions. There is no assurance that the plans will be able to earn the assumed rate of return. Market driven changes may result in changes in the discount rates and other variables which would result in Fraser Papers being required to make contributions in the future that differ significantly from the estimates. There is an inherent measurement uncertainty incorporated into the actuarial valuation process.

Environmental

Our operations are subject to a wide range of general and industry specific environmental laws and regulations relating to air emissions, wastewater discharges, solid and hazardous waste management, plant and wildlife protection, and site remediation.

Compliance with these laws and regulations is a significant factor in our business and we occasionally incur significant capital and operating expenditures in order to maintain compliance with these laws and regulations. Future events such as changes in environmental laws and regulations, increasingly strict enforcement policies or the discovery of previously unknown contamination or other liabilities relating to our properties may give rise to additional costs that could require increased capital expenditures which would reduce the funds otherwise available for operations, capital expenditures, future business opportunities or other purposes.

CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), on a timely basis so that appropriate decisions can be made regarding public disclosure. An evaluation of the effectiveness of the design and operation of Fraser Papers' disclosure controls and procedures was conducted as of December 31, 2008, by management, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that Fraser Papers' disclosure controls and procedures as defined in National Instrument 52-109, Certification of Disclosure in Issuers Annual and Interim Filings, are effective.

Under the supervision of the CEO and CFO, Fraser Papers has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. The CEO and CFO considered the need to disclose in this MD&A any change in Fraser Papers' internal controls over financial reporting that has occurred during the year that has materially affected, or is reasonably likely to materially affect Fraser Papers' internal controls and have not identified any such changes. An evaluation of the effectiveness of the design and operation of Fraser Papers' internal controls over financial reporting was conducted as of December 31, 2008, by management, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that Fraser Papers' internal controls over financial reporting as defined in National Instrument 52-109, Certification of Disclosure in Issuers Annual and Interim Filings, are effective and have not identified any material weakness related to design.

FORWARD-LOOKING INFORMATION

This MD&A contains forward-looking information and statements relating but not limited to: anticipated or prospective financial performance; results of operations; future investment in our operations; anticipated growth in target markets; profit margins; business strategy, including product development; our operating platform; energy reduction initiatives; expectations and estimations of future market conditions, including housing starts and home inventories; reduced oil consumption resulting from energy-reduction initiatives; modernization of our Plaster Rock lumbermill; evolving criteria and demand for certain paper grades; seasonal inventory build-up, reduction and the impact on financial results; future pension funding requirements; hedging activities; the Company's liquidity position, including financing requirements; maximum possible amounts under certain guarantees; the adoption of IFRS; and, the expected impact of specific events on financial results in the future.

Forward-looking information typically contains statements with words such as "should", "continue", "toward", "ongoing", "target", "result", "grow", "can", "future", "seek", "will", "achieve", "maintain", "look", "believe", "feel", "estimate", "plan", "possible", "could", "anticipate", "likely", "impact", "would", similar words, or variations of those words that suggest future outcomes. In addition, forward-looking statements may reflect the outlook on future changes in volumes, prices, costs, estimated amounts and timing of cash flows, or other expectations or beliefs, objectives or assumptions about future events or performance. Readers should be aware that these statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements.

The significant risks that impact Fraser Papers' business and future performance are discussed in the Annual Information Form as well as the Annual Report and other filings with Canadian securities regulatory authorities. Fraser Papers cautions that the list of risks and factors discussed in those documents may not be exhaustive. Readers should consider those risks, as well as other uncertainties and factors and potential events. Although Fraser Papers believes it has reasonable basis for making the forward-looking statements included in this report, readers are cautioned not to place undue reliance on such forward-looking information.

Fraser Papers undertakes no obligation, except as required by law, to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

The "Outlook" sections that follow in this document are based on Fraser Papers' views and the actual outcome is uncertain.

OUTLOOK

Fraser Papers expects a number of challenging quarters ahead as the effects of a global recession play out in the U.S. economy, and in Fraser Papers' market segments in particular. Business activity slowed sharply toward the end of last year and led to reduced demand for all our products. The pulp and lumber markets were particularly impacted with market prices dropping to extremely low levels. Prices for Fraser Papers' paper products were more stable, but as order files declined, we took downtime across a number of machines, in addition to shutdowns at Thurso and the lumbermills.

Our sales are largely focused in the United States, therefore the outlook for a recovery in Fraser Papers' business will be partly dependent on the success of the recently announced stimulus package and the availability of liquidity to restore both credit and confidence into the economy and, in particular, into our customers and end-markets. Despite taking downtime on paper machines to balance inventories against customer orders in December and January, we built inventories in excess of our near-term requirements. Subsequent to the year end, Fraser Papers sold approximately 10,500 tons of inventory to an affiliate of Brookfield, on customary commercial terms. The proceeds of the sale were used to repay amounts outstanding on the Company's working capital facility. We believe that over the longer term, the specialty nature of our paper products will help to position Fraser Papers to benefit from an economic recovery sooner than many other companies in the paper industry.

The market for northern bleached hardwood kraft pulp produced at our Thurso mill continues to be weak. By the fourth quarter, world pulp inventories had increased to unsustainable levels following a sharp decline in global demand from paper producers. It is expected that further capacity reductions will be required in northern Europe and North America to balance supply and demand, as low cost capacity in South America and Southeast Asia continues to operate.

With no clear signs of recovery in the U.S. housing market, lumber prices are expected to remain depressed for the balance of 2009. We will continue evaluating opportunities to secure low cost woodchips for the paper operations in Madawaska and will operate our lumbermills in support of our integrated paper operations.

Input costs for energy, chemicals and other raw materials have begun to weaken following a period of inflationary pressure. With a significant number of assets located in Canada, which incur Canadian dollar-denominated costs, the weakness in the Canadian currency has helped to improve the competitiveness of those operations. To eliminate a significant amount of risk related to the future volatility in the Canadian dollar, the Company has bought forward approximately 40% of its 2009 Canadian dollar requirements at an exchange rate of CAD\$1.00 = US\$0.79.

We expect to require additional financing during 2009 to fund our operations, pension fund obligations and the maturity of the \$25.0 million term loan facility in September. Given the challenging conditions in the credit markets, we expect that we may have to seek support from our shareholders.

DEFINITIONS

As there is no generally accepted method of calculating the measures outlined below, these measures as calculated by Fraser Papers may not be comparable to similar titled measures reported by other companies.

EBITDA is earnings from continuing operations before interest, taxes, depreciation and amortization, and restructuring charges. EBITDA is presented as a useful indicator of a company's ability to meet debt service and capital expenditure requirements. Fraser Papers interprets EBITDA trends as an indicator of relative operating performance.

Free Cash Flow is the Company's cash flow from operating activities minus capital investments.

Net debt is debt less cash and cash equivalents. Net debt to net debt plus equity is provided as a useful indicator of a company's financial leverage.

Net debt to net debt plus equity is net debt divided by the sum of net debt and shareholders' equity. Net debt to net debt plus equity is provided as a useful indicator of a company's financial leverage.

Cash costs include all cash costs of operations and exclude depreciation and amortization. Cash costs are presented to provide additional information about the cash generating capabilities of Fraser Papers' operations. This measure captures the key costs of operations and is a key performance measure that management uses to evaluate costs at the operations.

EBITDA (US\$millions)	Twelve months ended December 31	
	2008	2007
Profit / (Loss)	\$ (71.9)	\$ (43.1)
Add: Interest expense, net	3.6	6.8
Less: Income tax (recovery)/expense	(0.1)	(13.4)
Less: Gain on sale of Acadian	—	(38.4)
Add: Restructuring charges	—	15.9
Add: Other	—	(0.8)
Add: Depreciation	34.8	31.1
EBITDA	\$ (33.6)	\$ (41.9)

Net Debt (US\$millions)	As at December 31	
	2008	2007
Long-term debt	\$ 64.0	\$ —
Add: Current debt	25.0	—
Add: Bank indebtedness	7.4	4.3
Add: Borrowings under credit facility	—	81.6
Net debt	\$ 96.4	\$ 85.9

Net Debt to Net Debt Plus Equity (US\$millions)	As at December 31	
	2008	2007
Net debt	\$ 96.4	\$ 85.9
Add: Shareholders' equity	284.3	292.9
Net debt plus equity	380.7	378.8
Net debt	\$ 96.4	\$ 85.9
Divided by: Net debt plus equity	380.7	378.8
Net Debt To Net Debt Plus Equity	25%	23%

Free Cash Flow <i>(US\$millions)</i>	Twelve months ended December 31	
	2008	2007
Cash flow from operating activities	\$ (45.9)	\$ (48.2)
Less: Capital investments	(27.1)	(20.3)
Free Cash Flow	\$ (73.0)	\$ (68.5)

Cash Cost <i>(US\$millions)</i>	Twelve months ended December 31	
	2008	2007
Net sales	\$ 688.6	\$ 714.7
Less: EBITDA	33.6	41.9
Cash Cost	\$ 722.2	\$ 756.6

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.



J. Peter Gordon
Chief Executive Officer

February 4, 2009



Glen McMillan
Senior Vice President and Chief Financial Officer

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.

Toronto, Canada
February 4, 2009

Ernst & Young LLP
Chartered Accountants
Licensed Public Accountants

Consolidated Balance Sheets

As at December 31
(US\$millions)

2008

2007
(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

<i>Years ended December 31</i> <i>(US\$ millions, except per share amounts)</i>	2008	2007 <i>(restated – note 2)</i>
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 <i>(note 16)</i>	—	38.4
Restructuring charges <i>(note 17)</i>	—	(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 <i>(note 9)</i>	0.1	13.4
Loss	\$ (71.9)	\$ (43.1)
Loss per share – basic and diluted <i>(note 10)</i>	\$ (1.48)	\$ (1.47)
Deficit		
Balance, beginning of year	\$ (203.0)	\$ (162.0)
Change in accounting policy <i>(note 2)</i>	—	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

<i>Years ended December 31 (US\$millions)</i>	2008	2007 <i>(restated – note 2)</i>
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 the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook *Section 3865, Hedges*, 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 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 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 value 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 <i>(note 8)</i>	\$ 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 (<i>note 17</i>)	—	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)

	2008	2007
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 (CAD\$)	Number of Options	Weighted Average Exercise Price (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:

Year granted	Options Outstanding			Options Vested and Exercisable
	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price ⁽¹⁾ (CAD\$)	Number of Options
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 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.

Directors and Officers of Fraser Papers

DIRECTORS

Rorke B. Bryan, Ph.D. ⁽³⁾ ⁽⁴⁾
Corporate Director

Jack L. Cockwell, CA ⁽⁴⁾
Group Chairman
Brookfield Asset Management Inc.

Paul E. Gagné, CA ⁽¹⁾ ⁽⁴⁾
Chairman
Wajax Income Fund

Dominic Gammiero
Chairman
Fraser Papers Inc.

J. Peter Gordon
Chief Executive Officer
Fraser Papers Inc.

Robert J. Harding, FCA ⁽²⁾
Chairman
Brookfield Asset Management Inc.

Aldéa Landry, C.M., Q.C. ⁽¹⁾ ⁽²⁾ ⁽³⁾
President
Landal Inc.

Margot Northey, Ph.D. ⁽¹⁾ ⁽²⁾ ⁽³⁾ ⁽⁴⁾
Corporate Director

Samuel J.B. Pollock, CA ⁽³⁾ ⁽⁴⁾
Senior Managing Partner, Infrastructure
Brookfield Asset Management Inc.

OFFICERS

Dominic Gammiero
Chairman

J. Peter Gordon
Chief Executive Officer

Jeffrey Dutton
President and
Chief Operating Officer

Glen McMillan
Senior Vice President
and Chief Financial Officer

William Manzer
Senior Vice President,
Business Strategy and Projects

Matthew Nightingale
Vice President, Marketing

Marina Mueller
Assistant Corporate Secretary

Committees of the Board:

(1) Audit

(2) Corporate Governance and Nominating

(3) Environment, Health and Safety

(4) Human Resources and Pension

For a full description of the Board committees, and corporate governance practices, please see Fraser Papers' Management Information Circular on our web site at www.fraserpapers.com

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Note: This report contains forward-looking information that is based on certain assumptions and reflects the Company's current expectations. Forward-looking information typically contains statements with words such as "consider", "anticipate", "believe", "expect", "plan", "intend", "likely", "will", "could", "seek", "estimate", "possible", "foresee", "can", "should" or similar words, or variations of those words suggesting future outcomes. Readers should be aware that these statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. Significant risks that impact Fraser Papers' business and future performance are discussed in the Annual Information Form and other documents filed with Canadian securities regulatory authorities. The Company cautions that the list of risks and other factors discussed in those documents may not be exhaustive and readers should consider those risks, as well as other uncertainties and factors and potential events. Although Fraser Papers believes it has reasonable basis for making the forward-looking statements included in this report, readers are cautioned not to place undue reliance on such forward-looking information. Fraser Papers undertakes no obligation, except as required by law, to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

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