FraserPapers

ANNUAL REPORT 2005

Corporate Profile

Fraser Papers is an integrated specialty paper company which produces a broad range of technical and printing & writing 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*

A New Format

This year we have changed the format of our Annual Report to make it more cost effective. This Annual Report contains our annual letter to shareholders together with management's discussion and analysis of financial results and the audited consolidated financial statements for 2005.

Financial Highlights

(US$ millions, except per share data)	**2005**	2004[3]
Net sales[1]	**$ 918**	$ 996
EBITDA	**4**	20
Loss	**(29)**	(43)
Total assets	**788**	770
Net debt	**76**	41
Number of common shares outstanding[2]	**29.5**	30.1
Loss per share, basic and diluted	**$ (0.98)**	$ (1.43)
Total paper produced (000 tons)	**723**	840

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

(2) Millions of shares.

(3) See note 1 of Notes to the Consolidated Financial Statements, "Basis of Presentation" for 2004 figures.

Contents

Letter to Our Shareholders

2005 was a challenging year for Fraser Papers and for the paper industry in general. Rising manufacturing input costs for fibre and energy, as well as the impact of the rising Canadian dollar, continue to negatively impact producers. However, there were significant capacity closure announcements this year that favour an improved supply demand balance for companies like ours with a strong balance sheet and product mix. More importantly, within this difficult environment, we made considerable progress on our asset repositioning initiatives, surfaced value from our timberland assets, exited non-core operations and strengthened our balance sheet.

In this, our second year as a public company, I am pleased to share with you our progress in strategically repositioning our company for the longer term, our financial results, and our view of the market and outlook for 2006.

FINANCIAL PERFORMANCE

In 2005, Fraser generated a net loss of $29 million or $0.98 per share. These results are disappointing, but we believe, as I stated above, that our strong balance sheet, our ongoing asset repositioning and our cost reduction initiatives position us well for the future.

Our balance sheet is one of the strongest in the paper industry and we are committed to maintaining that competitive advantage. We took steps early in 2005 to further solidify our financial position. We raised $150 million of 10 year debt in U.S. capital markets at a fixed rate of 8.75%, which we believe is attractive pricing for the term of the financing. The proceeds were used to refinance short-term debt and buy out certain obligations which were guaranteed by our former parent company.

We also took advantage of the opportunity to enhance shareholder value through our active share repurchase program. During 2005 we repurchased 602,100 common shares under our normal course issuer bid at an average price of CAD$12.79. Our share performance is in line with the paper industry, although we continue to believe that our shares are undervalued and represent an opportunity for reinvestment in our company.

STRATEGY IN ACTION

Since taking Fraser public, we have been focused on executing our stated strategy to surface value for shareholders by:

- repositioning assets to improve operating leverage and flexibility;
- reducing costs and improving operational efficiency; and
- operating in markets where we can achieve sustainable competitive advantages.

Our goal is to reposition Fraser as a margin focused, technical specialty, and high value printing & writing paper business with operations concentrated in the U.S. northeast. Outlined below are specific initiatives achieved in 2005 that further our strategy and objectives.

Asset Repositioning

In 2005, we determined that timberland assets were trading at values that exceeded those reflected in our market valuation, so we seized the opportunity to surface this additional value for shareholders, while at the same time securing our long-term fibre supply. In the second quarter of 2005, we completed the sale of our Maine timberlands for pre-tax proceeds of $78 million. And early in 2006, we sponsored the launch of the Acadian Timber Income Fund, which acquired our timberlands in New Brunswick at an attractive value. This transaction is unique in that it allowed us to monetize the value of these timberlands for our shareholders, affirm fibre security for our East Papers operation and at the same time, participate in the market upside through a retained ownership in the fund of approximately 22%.

During the year, we also sold our Midwest text and cover business as well as our paperboard business in Edmundston. With small market share and a challenging competitive environment impacting their ability to generate sustainable profitability, the sale of these two non-core businesses furthered our repositioning strategy and will enable us to focus our capital and attention on situations with superior margin opportunities.

Cost Reduction

Fraser's margin improvement program is the primary driver of our cost reduction initiatives. During 2005, we implemented a restructuring at two of our operations, which included the reduction of our workforce and the retraining of approximately 100 people. In addition, Fraser's work hours per ton of pulp and paper produced – a measure of our labour productivity – improved by 15% from 4.80 in 2004 to 4.20 in 2005.

In total, we achieved $15 million in margin improvements that will enhance our cost structure. This is significant, but short of our stated goal of $50 million. Difficult market conditions and a lack of progress on various operating initiatives kept us from achieving our goal. As we look ahead to 2006, we will redouble our efforts to reduce costs throughout the organization with a goal of $30 million in margin improvements.

Product Development

Our product development activities are focused on increasing sales of our technical specialty papers from our Madawaska mill. In 2005, 12% of our production from this facility was made up of products developed within the last two years. In 2005, we developed a total of 36 new specialty paper products. We achieved 15% growth of our technical specialty paper volumes in 2005. This represents an acceleration from our historical growth rate of 8% per year for the previous six years.

The success of our product development initiatives this year allowed us to eliminate several low margin products, and to continue to refocus our production capacity toward specialty papers. We expanded market share in unique specialty papers such as non-telomer based packaging papers, flame retardant papers, magnetic ticket papers, thermal papers, lightweight printing papers, and uncoated groundwood specialty papers.

While cost inflation did not allow us to realize the full potential of the new products we launched in 2005, we believe that our ongoing investment in product development provides us with a strong product mix to fuel growth and enhance our competitiveness and improve margins.

MARKETS

As a technical specialty and high value printing & writing paper company, we operate in several different but related markets, all of which had challenges as well as opportunities in 2005. Capacity closures for printing & writing papers announced in 2005 exceeded 2 million tons in North America. These closures were concentrated in the freesheet segments of the paper business. A portion of this capacity, however, was in the lightweight opaque markets where we have a significant competitive advantage. This positions us well to grow our market share.

We grew our technical specialty paper business by 15% in 2005, and this paper segment now represents 29% of our total sales volume. Our technical specialty papers are used to manufacture a broad range of consumer products including pet food bags, labels, lottery tickets, thermal receipts and sugar packets. The markets for our technical specialty papers are driven by the demand for several consumer goods and the markets for these types of products are generally linked to consumer spending patterns and economic growth.

Fraser's specialty printing & writing papers are predominantly lightweight opaque papers, such as the paper this report is printed on. These papers are used for Bibles, pharmaceutical inserts, reference materials, financial publications and commercial printing. We provide printers and publishers with a wide array of printing paper options that deliver outstanding printed opacity and durability for the most demanding applications along with a full range of brightness levels, shades, finishes, basis weights and bulking characteristics. In addition to lightweight opaque papers, our suite of printing & writing papers includes heavyweight opaque, uncoated groundwood, and coated groundwood papers.

Demand for printing & writing papers declined in 2005 due largely to electronic substitution and migration toward lower cost, often imported, papers. Uncoated groundwood papers represented the bright spot for 2005 where demand increased by over 3% in three key end use segments including directory papers, supercalendered papers, and hi-bright papers. Our realized prices for total printing & writing papers increased 5% in 2005, in part due to price increases, but largely due to an improved product mix and larger sales volumes of higher value grades.

Our uncoated groundwood hi-bright paper business grew strongly during the year, increasing 17%, as publishers and printers increasingly utilized these papers for their book publishing needs. We developed new brightness levels for the hi-bright market and qualified the only ultra lightweight hi-bright uncoated groundwood paper manufactured in North America. We expect demand for hi-bright groundwood papers to continue to increase as they represent an equal quality, low cost substitute in several printing applications. We look to continue to grow our uncoated groundwood business, which currently represents 16% of our total paper volumes.

From a pricing perspective, groundwood papers pricing increased in 2005, while prices decreased for commodity uncoated freesheet paper grades. Despite an extremely difficult paper market, we were able to increase our selling prices in 2005 by eliminating our lowest margin grades and replacing them with higher value products. Approximately 75% of the low margin paper grades that we eliminated in 2005 were commodity uncoated freesheet papers, further reducing our exposure to the pricing volatility of commodity products.

Pulp markets strengthened in 2005 leading to improved pricing in most markets. World pulp inventory declined in 2005 indicating some stabilization in the market. However, significant announcements of capacity additions in South America are likely to dampen the upside in world pulp prices.

Prices for lumber were strong in the first quarter of 2005 but declined later in the year as markets became oversupplied. In response, our Canadian sawmills took one month of downtime in the fourth quarter of 2005. Overall, we expect lumber prices in the coming year to remain consistent with 2005 levels. Improvements in the lumber markets could come from sustained high levels of new home construction, but this could be mitigated by increasing supply from the interior of British Columbia as that region continues to overharvest as a result of the pine beetle infestation.

CORPORATE GOVERNANCE

Our goal is to exceed the best corporate governance practices of leading companies in Canada and the United States. Fraser's Board of Directors and management team are committed to continuously reviewing our policies and practices to ensure strong accountability to our shareholders. During 2005 we introduced minimum shareholdings for members of the Board and senior management and added an additional independent director to our Board. In addition, we have introduced an annual evaluation to assess the effectiveness of the Board and its committees. The Chairman oversees this process, which includes self-assessment, skills evaluation and peer feedback for directors. The Corporate Governance and Nominating Committee assesses the results as the basis for recommending change. Our Corporate Governance Practices are set out in greater detail in our Management Proxy Circular and are also available on our web site at *www.fraserpapers.com.*

LOOKING AHEAD

In 2006, we will strive to achieve improved operating earnings from our asset repositioning initiatives and future cost reductions. We are anticipating improvements in the supply and demand balance resulting from the accelerated pace of capacity closures in the industry in 2005, and we are well positioned to benefit from future price increases in the paper markets.

We continue to assess the potential for acquiring the Katahdin Paper Company, an operation that has the potential to capture profitable market share in super-calendered A and directory paper markets. We will also pursue other opportunities to enhance our franchise and strengthen our market position in the U.S. northeast.

We will continue to aggressively implement our margin improvement program in the coming year while we execute our business strategy. We believe that substantially all of the repositioning initiatives will be completed in 2006. And with a strong balance sheet and product development, we are well positioned to participate in the ongoing consolidation of our industry and to seize opportunities to foster profitable growth.

Your senior management team remains committed to enhancing the profitability of our business and surfacing value for shareholders. We are confident that our progress in the past two years in strengthening our operating platform, together with the energy and enthusiasm of our employees, will enable us to continue to meet the needs of our customers for unique, high quality products and to build a lasting leadership position in our industry.

On behalf of the entire Fraser team, thank you for your continued support.

Dominic Gammiero
President and Chief Executive Officer

February 7, 2006

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

The following discussion and analysis presents the factors that had a material effect on our results of operations during the years ended December 31, 2005 and 2004. 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, 2005 and 2004 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 Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. See "Forward-Looking Information"

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

EBITDA, net debt, net debt to net debt plus equity, and free cash flow are non-GAAP measures described in the Definitions section at the end of this Management's Discussion and Analysis ("MD&A"). Non-GAAP measures do not have any standardized meaning prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other companies. These measures are presented because we believe they are useful measures of our liquidity, our operating performance, our financial position or our financial leverage. However, they should not be considered as alternatives to net cash provided by operating activities as a measure of our liquidity or as alternatives to net income as an indicator of our operating performance or any other measure of performance in accordance with Canadian GAAP. There are no directly comparable GAAP measures to any of these measures. However, a quantitative reconciliation of each non-GAAP measure to the nearest comparable GAAP measure is provided in the Definitions section.

In this MD&A, "Fraser Papers", "we", "us" and "our" refer to Fraser Papers Inc. and all of its consolidated subsidiaries and affiliates for periods subsequent to June 30, 2004 and the Fraser Papers division of Norbord for periods up to June 30, 2004, and "Company" means Fraser Papers Inc. as a separate corporation. "Norbord" refers to Norbord Inc. or any of its consolidated subsidiaries. "Brookfield" means Brookfield Asset Management Inc., formerly Brascan Corporation, (a related party by virtue of a significant shareholding in the Company) or any of its consolidated subsidiaries. The date of this MD&A is March 7, 2006.

INTRODUCTION

This Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to provide investors with an understanding of the historical performance of our business, its financial condition and its prospects.

OVERVIEW OF BUSINESS

We are an integrated specialty paper company which produces a broad range of technical and printing & writing papers. We also produce northern bleached hardwood kraft market pulp and dimension lumber in both Canada and the United States.

Distribution of Fraser Papers

On June 30, 2004, Norbord completed a reorganization whereby, among other things, it transferred its interest in its paper, pulp, lumber and timber assets to Fraser Papers and then distributed the shares in the Company to its shareholders. We became a separate publicly traded company governed by the *Canada Business Corporations Act* ("CBCA"). This distribution was effected by way of a plan of arrangement (the "Arrangement") under the CBCA. Norbord common shareholders effectively received one share of the Company for each five shares of Norbord held. A full discussion on the impact of the distribution on our financial statements and accounting policies is provided in Note 1 to the consolidated financial statements. Readers are cautioned that as a result of the basis of presentation as described in Note 1 to the consolidated financial statements, the operating results for periods prior to June 30, 2004 may not necessarily be indicative of the revenues and expenses that would have resulted had the Division operated as a stand-alone entity during those periods.

Prior to the Arrangement, all of our financing requirements were provided by Norbord. In addition, a significant portion of our accounts receivable was sold to Norbord.

Strategy

One of our objectives is to achieve a 12% return on equity over the economic cycle while providing share capital growth for shareholders. In 2005 we had two business segments: Paper and Timber. The Paper segment includes our paper, pulp and lumber operations. The Timber segment included the operations of our Maine and New Brunswick timberlands, which we have divested.

Our business plan has been designed to contribute to our corporate objectives. Our plan involves:

- further reducing costs and improving performance at each of our operations;
- repositioning assets to surface additional value to shareholders;
- building the business selectively and opportunistically, based on value;
- focusing on products where Fraser Papers has or can develop sustainable competitive advantage; and
- enhancing equity return by maintaining an appropriate level of financial leverage at the lowest cost.

We believe that a focus on improving margins is key to increasing shareholder value. We track improvements in product mix and customer mix, volumes and cost reductions and report quarterly to shareholders under our margin improvement program. During 2005, we generated margin improvements of $15 million relative to 2004. During 2004, we generated margin improvements of $42 million relative to 2003. Our efforts to improve margins in 2005 were challenged by significant cost increases in our major manufacturing inputs, namely fibre, energy, and the effect of the stronger Canadian dollar. We have identified a number of initiatives for improving our profitability which we will implement in 2006.

We will continue to explore asset repositioning opportunities in an effort to ensure optimal use of capital. During 2005, we executed our strategy of surfacing capital from our timberlands. We monetized our Maine timberlands in 2005 and our New Brunswick timberlands in January, 2006. We generated net cash proceeds of approximately $172 million from these transactions, unlocking significant value. While we have divested our timberlands, we have maintained fibre security through long-term fibre supply agreements. These agreements give the Company the right to purchase, at market prices, the same volumes of fibre that it historically received from these lands. We maintain an interest in our New Brunswick timberlands through our 22% fully-diluted interest in Acadian Timber Income Fund (“Acadian” or the “Fund”). See discussion in “Recent Developments”.

We continue to focus our product development efforts on higher value products. Our goal is to replace the least profitable 10% of our products each year with higher value products. In 2005, we developed 36 new specialty paper products.

Maintaining a strong balance sheet is important in a cyclical business. Our conservative capital structure provides flexibility in considering our objectives. On March 15, 2005, the Company issued $150 million of senior, unsecured notes and repaid previously outstanding debt of $75 million. At December 31, 2005, Fraser Papers continues to have one of the strongest balance sheets among its public competitors with a ratio of net debt to net debt plus equity of 15%. With the sale of our New Brunswick timberlands in 2006, we have net cash on our balance sheet.

We will explore growth opportunities only if they are consistent with our objectives. We regularly consider acquisition opportunities as they arise. In 2006, we will explore the acquisition of Katahdin Paper Company LLC (“Katahdin”), an asset we have managed since 2003.

RECENT DEVELOPMENTS

Monetization of New Brunswick Timberlands Assets

On January 31, 2006, the Company sold its timberlands in New Brunswick to Acadian. Acadian is a newly formed income fund which financed the acquisition through an initial public offering of equity securities and the issuance of bank debt. The Company was the promoter of the Fund.

The Company received net proceeds of approximately $125 million. The proceeds included cash of $94 million and $31 million of securities. The securities are convertible into 3,613,780 units of the Fund, representing a 22% interest in the Fund on a fully-diluted basis. These securities are entitled to the same rights as units of the Fund. The Company expects to record a gain on the sale in the first quarter of 2006 and expects to account for its ongoing interest in the Fund on an equity basis. The Company’s investment in the Fund entitles it to regular cash distributions from the Fund to the extent that the Fund declares them.

Sale of Maine Timberlands

During the second quarter of 2005, Fraser Papers sold 240,000 acres of timberlands in Maine resulting in net proceeds of $78 million and a pre-tax gain of $46 million. At the time of the sale, Fraser Papers entered into a 20 year fibre supply agreement under which it will receive substantially the same volumes of fibre that it historically received from these timberlands.

The operations of the New Brunswick and Maine timberlands represented all the assets of the Timber segment. The Timber segment generated EBITDA of $12 million in the year ended December 31, 2005 as compared to $11 million in 2004.

Sale of Paperboard Assets and Restructuring Charges

In the fourth quarter of 2005, Fraser Papers sold its paperboard assets (the “Paperboard Operations”), located in Edmundston, New Brunswick, for proceeds of $5 million. The Company’s small market share, increased cost structure and structural changes in the industry were impacting Fraser Papers’ ability to generate sustainable profitability from these operations. The sale of the Paperboard Operations is consistent with the Company’s strategy to position itself as an integrated producer of technical specialty and high value printing & writing papers.

As a result of the sale, the Company reduced its workforce by 98 positions at its mill in Edmundston, New Brunswick. The elimination of these positions resulted in a restructuring charge of $8 million consisting of severance and early retirement costs of $5 million and a non-cash charge for pension and non-pension post-retirement benefits of $3 million. An impairment charge of $1 million was also recognized in the third quarter. The proceeds of $5 million that the Company generated on the sale of the Paperboard Operations will fully offset the cash exit costs of $5 million. The terminations and other restructuring activities are expected to be completed over the next two quarters. The Company expects that the disposition of the Paperboard Operations will result in an estimated annual improvement in EBITDA of $2 million.

In addition, in the fourth quarter of 2005, the Company sold two non-core properties for total proceeds of $2 million. There were no gains recorded on these sales.

In 2004, restructuring charges of $7 million represent the costs associated with downsizing at a number of Fraser Papers locations. The total charges relate to a workforce reduction of 190 positions and include severance, early retirement and other costs of $6 million and non-cash, pension and non-pension post-retirement benefits charges of $1 million.

At December 31, 2005 and December 31, 2004, restructuring reserves of $8 million and $4 million, respectively, were included in accounts payable and accrued liabilities.

Sale of Midwest Operations

In the first quarter of 2005, we sold our text and cover business consisting of a production facility in Park Falls, Wisconsin, a leased distribution facility in West Chicago, Illinois and related net assets (the "Midwest Operations") to Smart Papers LLC ("Smart Papers"), a manufacturer of premium coated and uncoated papers. Fraser Papers realized no gains or losses on the sale of the assets. As consideration for these net assets, Fraser Papers received a passive 40% minority interest in the purchaser, which owns similar assets. The agreement includes various representations, warranties and indemnities which are standard for transactions of this nature. However, any breach of any warranty or claim under an indemnity could result in an increase or decrease in our percentage of ownership. Our interest in Smart Papers is accounted for on an equity basis.

The consolidated financial statements include an EBITDA loss of $3 million related to the Midwest Operations for the period from January 1, 2005 through to the date of sale. For the year ended December 31, 2005, the financial statements reflect equity losses related to Smart Papers of $8 million, including depreciation of $6 million.

Investment in Equipment and Leases

During the second quarter of 2005, Fraser Papers acquired a cogeneration power facility in Berlin, New Hampshire for $34 million from Brookfield. In addition, the Company acquired various manufacturing and mobile equipment previously under lease for $19 million. These transactions are consistent with Fraser Papers' commitment to remove Norbord from various guarantees it had provided at the time of the Arrangement. See discussion in "Contractual Obligations".

The assets acquired include a boiler in Park Falls, Wisconsin. Fraser Papers has leased that asset to Smart Papers. The lease runs through 2014 and is considered a direct financing lease due primarily to the ability of Smart Papers to purchase the boiler at the end of the lease term for a nominal amount. Lease payments of $2 million due in the next twelve months are included in accounts receivable. Lease payments due beyond one year of $14 million are included in other assets. Unearned finance income of $1 million will be recorded in earnings over the life of the lease.

Impairment Charges

During 2005, the Company recorded a pre-tax, non-cash impairment charge of $40 million against the assets of its pulp mill in Thurso, Quebec. The Company performed an impairment review and considered the continued strength of the Canadian dollar, increasing input costs and significant worldwide pulp capacity additions, which have negatively affected the long-term profitability of this operation, to be indicators that the carrying amount of these assets may not be recoverable. As a result, the Company evaluated the recoverability of Thurso's long-lived assets and recorded an impairment charge equal to the amount by which the carrying value of the assets exceeded their fair value. The fair value of the assets was determined using a discounted cash flow analysis of the long-term projected operating results of the mill.

Prior to the sale of its Paperboard Operations, the Company recorded an impairment charge of $1 million on the basis of receiving a firm offer to purchase the Paperboard Operations.

Issuance of Senior Unsecured Notes

On March 17, 2005, the Company issued $150 million of senior unsecured notes. These notes mature in March 2015 and bear interest at an annual rate of 8.75%. Prior to the end of the first quarter, a portion of the proceeds from this offering was used to repay $75 million outstanding on the revolving term facility, which was then cancelled. The indenture agreement governing the notes contains certain covenants, the more significant of which include the restrictions on the incurrence of additional indebtedness, the sale of assets, mergers, the creation of liens, the payment of dividends and the repurchase of the Company's shares.

BUSINESS PROFILE

Headquartered in Toronto, Canada, we employed approximately 3,000 people at December 31, 2005 at manufacturing facilities in the United States and Canada. The geographical breakdown of property, plant and equipment at the end of 2005 was 57% U.S. and 43% Canada.

Principal manufacturing facilities included:

- 13 paper machines at two integrated pulp and paper mills;
- one market pulp mill; and
- four sawmills.

The annual production capacity of these facilities at December 31, 2005 was:

- 675,000 tons of paper, including towel;
- 460 million board feet of lumber; and
- 400,000 tonnes of market pulp.

The Company has secured a portion of its supply of fibre through long-term fibre supply agreements with customers, as well as its Crown licenses in Canada. Fraser Papers also purchases timber, chips and other wood residues on the open market.

In addition, we manage Katahdin, an affiliate of Brookfield, for a management fee.

KEY FACTORS AFFECTING OUR BUSINESS

Our operating results are influenced by a number of key factors including the selling prices of our products, fibre costs, energy costs and U.S. dollar–Canadian dollar exchange rates.

Our operating results are largely affected by the prevailing market prices for paper, pulp and lumber. The markets for our products are highly cyclical and affected by such factors as global economic conditions, consumer demand, residential and commercial construction in North America, as well as changes in industry production capacity and inventory levels.

The paper, pulp and lumber industries are characterized by periods of shortage and rapidly rising market prices, leading to increased production and increased industry investment until supply exceeds demand. Those periods are then typically followed by periods of reduced market prices and excess idled capacity until the cycle is repeated.

In addition, Canadian lumber markets and our results have been impacted by the softwood lumber dispute which resulted in the introduction of countervailing duties ("CVD") and anti-dumping duties ("ADD") in the United States. We sell substantially all of our lumber in the U.S. In the year ended December 31, 2005, we paid ADD of approximately $3 million on all softwood lumber exports from Canada to the U.S., compared to $6 million in 2004. Since the introduction of the ADD, total duties paid amount to $15 million. In response to these duties, many Canadian lumber producers have increased their lumber output in order to reduce unit costs, which has exacerbated the oversupply condition in North American lumber markets. In December 2005, the U.S. Department of Commerce established new CVD and ADD rates. The rate of ADD applicable to Fraser Papers' lumber exports decreased to 2.1% as compared to 3.8% previously.

Management believes that maintaining a leadership position in our technical specialty paper business, enhancing the value of our fine paper and groundwood paper offerings, responding effectively to competitive challenges, employing capital optimally, controlling costs and managing currency and commodity risks, are important to the long-term success of the business.

Market Leadership. Achieving and maintaining leadership in the technical specialty paper business and growing the value of our fine paper and groundwood product offerings have been an important part of our past performance. We have long been recognized as an innovator in high quality technical papers and a leader in the development and production of lightweight and ultra-lightweight fine and groundwood papers used in packaging, thermal applications, grease resistant applications, financial printing, pharmaceutical printing and directory and high brightness groundwood grades.

Competitive Environment. Our results have been and will continue to be significantly affected by the competitive environment in which we operate. We experience intense competition for sales of our principal products in our major markets. Our paper business competes directly with well-known competitors, some of which are larger and more diversified than we are. In our pulp business, we have experienced and will continue to experience intense competition from southern hemisphere suppliers of hardwood pulps. In our lumber operations we compete with both larger regional companies and small local mills and woodlot owners.

The continuous cost pressures in our industry have affected a number of competitors. These developments have resulted in capacity reductions and announcements of future reductions. We expect that these closures should result in an improved supply and demand environment.

Cost Control. Timber and other fibre represent the largest portion of our manufacturing costs. Our timber requirements in 2005 and 2004 were met from lands that we owned, through timber supply and forest management agreements in Canada, and by purchasing wood from third parties. Following the divestitures of our timber operations, we have secured our long-term fibre supply through long-term fibre supply agreements with the new owners. We expect our fibre costs to marginally increase as a result of market-pricing mechanisms embedded in the new fibre supply agreements. The projected increase based on the historical prices in effect during 2005 is expected to amount to $3 million. Other fibre requirements, including pulp, woodchips and recycled materials, are purchased from third parties. We have seen our total fibre costs increase significantly over the past two years.

Energy costs such as oil, natural gas and electricity represent another significant portion of our manufacturing costs. In 2005, we acquired the cogeneration facility at our Berlin-Gorham operation. We currently have dedicated cogeneration facilities at our two integrated paper mills. These cogeneration facilities serve to mitigate the impact of some of these price fluctuations through the use of alternative fuel sources, such as biomass. Other significant manufacturing costs include labour and chemicals.

To improve and maintain our competitive position, we must control our raw material, manufacturing, distribution and other costs. Our focus on our margin improvement program is intended to achieve cost savings and improve productivity.

Foreign Currency and Commodity Risk. Sales of pulp and lumber by our Canadian manufacturing facilities are invoiced in U.S. dollars in accordance with industry practice. However, we are exposed to changes in foreign exchange rates because most of our costs at these facilities are incurred in Canadian dollars. These risks could have a material impact on our results of operations.

Margin Improvement

We are committed to an ongoing program of cost reduction at all of our operations. Our margin improvement program remains the cornerstone of our efforts to "control the controllables". This program measures improvements in EBITDA resulting from higher volumes, improved mix and cost reductions assuming constant exchange rates and commodity prices. Targets for the program are set annually and actual results are measured against these targets on a monthly basis. The Company's annual incentive programs are tied to the targets of the margin improvement program.

For the year ended December 31, 2005, Fraser Papers generated $15 million of margin improvements, far short of the stated goals. The majority of the improvement resulted from lower labour costs and decreased fixed costs, mainly as a result of restructuring initiatives undertaken in 2004. In 2004, Fraser Papers generated margin improvements of $42 million compared to 2003.

The benefits achieved under our margin improvement program and improved product prices for paper and pulp were more than offset by the negative impact of lower lumber prices and higher fibre and energy costs and the effect of the stronger Canadian dollar. Fibre, energy and foreign exchange negatively impacted our EBITDA in 2005 by $50 million relative to 2004.

During 2004, we generated margin improvements of $42 million. Increased production volumes and improved mix at some paper mills accounted for half of the improvements. Lower labour costs and other cost initiatives represented the other half. Since the fourth quarter of 2003, we have implemented workforce reductions that resulted in the elimination of over 500 positions, while improving our productivity levels. Of these positions, 190 were eliminated in the fourth quarter of 2004.

Softwood Lumber Duties

Effective May 22, 2002, the U.S. International Trade Commission imposed countervailing duties ("CVD"), and anti-dumping duties ("ADD") on Canadian lumber exported to the U.S. Our New Brunswick sawmills are subject only to ADD. In 2005, the total paid for these duties was $3 million, as compared to $6 million in 2004. We have paid total duties of $15 million from May 2002 through December 31, 2005.

Fraser Papers and other Canadian forest product companies, the Canadian Federal Government and Canadian provincial governments categorically deny the U.S. allegations. Decisions by various trade bodies have lowered the CVD rates and ADD rates from those initially established. Notwithstanding the rates established in the investigations, the final liability for the assessment of CVD and ADD will not be determined until the appeal process is complete or a negotiated settlement is reached.

RESULTS OF OPERATIONS AND RELATED INFORMATION

Selected Annual Information

($millions, except per share amounts)	**2005**	2004
Net sales (1)	**$ 918**	$ 996
EBITDA (2)	**4**	20
Loss	**(29)**	(43)
Total assets	**788**	770
Net debt	**76**	41
Loss per share, basic and diluted	**$ (0.98)**	$ (1.43)

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

(2) EBITDA excludes restructuring charges of $8 million in 2005 and $7 million in 2004.

Overview

We experienced lower EBITDA in 2005 in a challenging operating environment, underscored by significant cost pressures. We completed several initiatives to surface value, reposition assets and optimize our financial position:

- Announced the monetization of our timberlands in Maine as well as New Brunswick, generating net cash proceeds of approximately $125 million and a 22% interest in Acadian.
- Secured fibre supply, substantially equal to the fibre we previously received from the lands we sold in New Brunswick and Maine, for 20 years.
- Completed the sale of the Midwest Operations resulting in a more geographically concentrated portfolio of assets and streamlined costs.
- Divested the unprofitable Paperboard Operations while generating sufficient cash proceeds to cover the cash exit costs.
- Issued $150 million senior, unsecured notes, due March 2015.
- Reduced the amount of outstanding guarantees by Norbord Inc. from $84 million at December 31, 2004 to $13 million at December 31, 2005.
- Repurchased 602,100 common shares at CAD$12.79 per share.
- Achieved $15 million in margin improvements.
- Increased shipments of technical specialty papers from 180,000 tons in 2004 to 207,000 tons in 2005.
- Achieved environmental compliance of close to 100%.

Summary of Quarterly Results

($millions, except per share amounts)	Net Sales	Earnings (loss)	Earnings (loss) per share *(basic and diluted)*(1)
2005			
4th Quarter	**$ 219**	**$ (22)**	**$ (0.75)**
3rd Quarter	**226**	**(5)**	**(0.16)**
2nd Quarter	**217**	**(5)**	**(0.17)**
1st Quarter	**256**	**3**	**0.10**
2004			
4th Quarter	$ 257	$ (21)	$ (0.70)
3rd Quarter	261	2	0.07
2nd Quarter	257	(10)	(0.33)
1st Quarter	221	(14)	(0.47)

(1) Earnings (loss) per share for periods prior to the Arrangement are based on the assumption that the 30,111,976 common shares issued as a result of the Arrangement were issued and outstanding for those periods.

Quarterly sales and earnings are impacted by the seasonal trends in our main products with seasonal slowdowns in the fourth quarter. The technical specialty papers business generally experiences steady quarter to quarter shipments flow with a seasonal slowdown in the fourth quarter due to inventory adjustments and customer plant closures during the December holiday season. The fine and groundwood printing & writing paper businesses have historically experienced a steady flow of orders with weakness in the fourth quarter due to a slowdown in the printing industry and adjustment of customer inventories. The results of the pulp operations may be impacted quarter-over-quarter based on the timing of annual maintenance shuts, which typically take place during the second or third quarter. The lumber business is seasonal with demand peaking late in the first quarter and through the second quarter as the construction cycle begins its spring and summer activity. Activity slows in December and January as the annual construction cycle comes to an end.

In the fourth quarter of 2005, sales were lower than the same quarter of 2004, mainly as a result of the divestitures of certain operations in 2005. Earnings in the fourth quarter of 2005 were comparable to the fourth quarter of 2004. The results in the fourth quarter of 2005 were impacted by a market-related shutdown at our Canadian sawmills whereas our pulp operations took a market-related shutdown in the fourth quarter of 2004.

Net Sales

Net sales decreased by $78 million in fiscal 2005 to $918 million from $996 million in 2004. The decrease was the result of the sale of the Midwest Operations and the Maine timberlands earlier in the year, and the sale of the Paperboard Operations early in the fourth quarter. After adjusting for the divestitures, net sales were up $47 million or 6%. Higher sales in our pulp and paper operations, due to higher average selling prices as compared to 2004, were partly offset by lower lumber prices and volumes as compared to 2004. Paper segment sales accounted for 95% of net sales in 2005 and 2004 whereas Timber segment sales accounted for 5%. See discussion in “Segment Results”.

($millions)	**2005**	2004
Paper	**$ 874**	$ 952
Timber	**74**	85
Inter-segment	**(30)**	(41)
Total	**$ 918**	$ 996

Net sales for the fourth quarter of 2005 were $219 million, as compared to $257 million in the fourth quarter of 2004. After adjusting for the divestitures, net sales were 2% higher than the fourth quarter of 2004, due to higher pulp shipments and pricing, partly offset by lower lumber sales. See discussion in "Segment Results".

EBITDA

EBITDA decreased by $16 million in fiscal 2005 to $4 million from EBITDA of $20 million in fiscal 2004.

($millions)	**2005**	2004
Paper	**$ (8)**	$ 9
Timber	**12**	11
Total (1)	**$ 4**	$ 20

(1) EBITDA excludes restructuring charges of $8 million in 2005 and $7 million in 2004.

In 2005, the Paper Segment reported an EBITDA loss of $8 million, down from EBITDA of $9 million in 2004. Within the Paper segment, the results of lumber and paper operations were lower while the results of our pulp operations improved. The EBITDA from our lumber operations was lower by $16 million due primarily to lower selling prices relative to 2004. Our paper mills generated EBITDA of $1 million compared to $14 million in 2004 as selling price improvements were more than offset by higher costs for energy and fibre and the impact of the stronger Canadian dollar. The results of our pulp operations improved as prices and volumes increased, but were negatively impacted by significant cost increases in energy, fibre and the strengthening Canadian dollar. The Timber Segment contributed $12 million of EBITDA, compared to $11 million in 2004. See discussion in "Segment Results".

EBITDA in the fourth quarter of 2005 was a loss of $7 million, unchanged from the fourth quarter of 2004. Our two Canadian sawmills took four weeks of market-related downtime in the fourth quarter of 2005, which affected the results of the lumber operations. In the fourth quarter of 2004, the results were affected by shutdowns taken at our pulp operations.

Depreciation

Depreciation expense for 2005 was $39 million, down from the $48 million recorded in 2004. The decrease in depreciation is due primarily to the sale of our Midwest Operations early in the year and the impairment charge recorded against the assets of the Thurso pulp mill.

Segment Results

Paper Segment

The Paper segment includes our paper, pulp and lumber operations at December 31, 2005. The Paper segment comprises 13 paper machines at two locations, two market pulp mills and four sawmills. The Paperboard Operations were sold in the fourth quarter of 2005.

($millions)	**2005**	2004
Net sales	**$ 874**	$ 952
EBITDA	**(8)**	9
Depreciation	**38**	47
Capital investments	**49**	6

The EBITDA for each of these operations is as follows:

($millions)	**2005**	2004
Paper	**$ 1**	$ 14
Pulp	**(15)**	(27)
Lumber	**6**	22
Total	**$ (8)**	$ 9

The Paper segment includes the production of uncoated freesheet and groundwood papers, paperboard, towel, hardwood pulp and softwood lumber. The Company sold its Midwest Operations and its Paperboard Operations in 2005 which resulted in a significant decrease in sales. EBITDA was lower by $17 million as improvements in pulp operations partially offset weaker results from the lumber and paper operations.

Markets

Paper

We manufacture technical specialty and publishing papers, which represent approximately 50% of our paper shipments in 2005, other uncoated freesheet grades, representing approximately 25% of our 2005 paper shipments, as well as coated and uncoated groundwood grades.

Specialty paper demand is not as sensitive to general industry trends as commodity grades. Pricing for fine paper grades including specialty and publishing papers was marginally higher compared to 2004. Our technical specialty paper volumes were higher by 15% in 2005 benefiting from growth in packaging, thermal transfer and super-calendered release markets. In 2004, our growth in those grades was 16%.

According to major industry publications, North American demand for printing & writing papers declined 2% in 2005 due largely to electronic substitution and migration toward hi-bright uncoated groundwood papers, which boosted demand for uncoated groundwood. Uncoated groundwood demand was stronger in 2005, as compared to 2004. Coated groundwood demand experienced declines.

2005 was characterized by continued declines in demand for uncoated freesheet products. Uncoated freesheet demand is generally seasonally weak in the last quarter of the year, but that was not the case in 2005. Uncoated freesheet started showing some signs of a turnaround towards the end of 2005. Capacity closures were keeping markets tight and allowing prices to stabilize. In addition, significant capacity closures have been announced for 2006.

The industry price for commodity uncoated freesheet paper grades decreased 10% over 2004. However, pricing for our specialty technical and printing & writing papers improved. Average industry prices for coated groundwood increased by 9% over 2004 while prices for uncoated groundwood increased by 4% over 2004.

Pulp

We manufacture northern bleached hardwood kraft pulp (“NBHK”), most of which is sold in the open market.

According to industry publications, average prices for NBHK increased from $535 per tonne in December 2004 to $595 per tonne in December 2005, with an average price around $595 for the year. Industry publications reported average prices of approximately $540 per tonne in 2004. The markets for this grade of pulp are influenced by global supply and demand with the largest variations in price often attributed to the purchasing patterns of large net pulp importing nations such as China. Strong demand from pulp importing nations supported the pricing increases in 2005.

In 2004, pricing was strong in the first half of the year. However, markets softened rapidly during the third quarter of 2004 as producer inventories rose. The low pricing environment in the fourth quarter of 2004 combined with the rising Canadian dollar led to significant industry-wide market downtime and announcements of permanent closures for several Canadian pulp mills. Our operations also took market-related downtime in the last quarter of 2004.

Lumber

North American softwood lumber demand and pricing started strong in 2005 but prices experienced significant declines in the second half of the year. Pricing in 2005 came off the record highs experienced in 2004 as increased supply moderated continuing strong demand driven by robust housing starts and remodelling activity. In 2005, average benchmark lumber prices (Eastern Boston SPF 2x4) were down approximately 10% compared to 2004. The depressed pricing environment combined with the continued strength of the Canadian dollar necessitated a four week market-related shutdown at our Canadian sawmills in the fourth quarter of 2005.

In 2004, North American demand for softwood lumber reached a record high. Benchmark lumber prices were very strong and averaged $448 per Mfbm in 2004, a 40% increase over the 2003 average. While pricing was generally strong throughout the year, prices declined in the fourth quarter of 2004, due to seasonal weakness, by approximately $50 per Mfbm or 15% of the 2004 average.

Operations

The sales, shipments and average prices of the major product groups within our Paper segment are summarized below:

	Net Sales ($millions)		Shipments (volume 000 tons)[1]		Average Mill Nets ($ per unit)[2]	
	2005	2004	**2005**	2004	**2005**	2004
Uncoated freesheet	**$ 410**	$ 515	**456**	557	**$ 898**	$ 925
Groundwood paper	**137**	130	**181**	186	**760**	702
Paperboard	**25**	30	**47**	57	**527**	517
Towel	**28**	25	**38**	38	**728**	669
Pulp	**169**	133	**371**	321	**455**	416
Lumber	**137**	149	**412**	427	**333**	350
Intra-segment and other	**(32)**	(30)				
Total	**$ 874**	$ 952				

(1) Pulp is 000 tonnes; Lumber is MMfbm.

(2) Lumber is per Mfbm.

Paper

Our uncoated freesheet volumes decreased significantly compared to 2004 due to the sale of our Midwest Operations in February 2005. The decrease in the average prices for uncoated freesheet was also the result of the sale of the Midwest Operations. Adjusting for the effect of the Midwest Operations, uncoated freesheet shipment volumes were up approximately 3% whereas pricing was marginally higher. Within the uncoated freesheet group of products, our technical specialty papers experienced a 15% increase in shipments. Commodity freesheet represented less than 25% of our uncoated freesheet shipments.

Our groundwood papers experienced a 3% decrease in shipments whereas prices improved by 8% compared to 2004. Disruptions in the marketplace, with the Finnish paper industry lockout and a strike at a major producer, decreased supply and contributed to a better pricing environment.

After adjusting for the sale of the Midwest Operations, our average mill net prices for all paper grades improved by 4%. Pricing improvements resulted in an estimated $26 million improvement in sales compared to 2004. However, increased fibre and energy costs and the impact of the stronger Canadian dollar more than offset pricing increases and the achieved margin improvements. As a result EBITDA of the paper operations decreased from $14 million in 2004 to $1 million in 2005.

The negative effect on the Paper segment EBITDA of higher fibre and energy costs was $32 million. The stronger Canadian dollar had a negative effect on EBITDA of $18 million as compared to 2004. In addition, the results in 2005 include the negative EBITDA of the Paperboard Operations and the Midwest Operations. The EBITDA loss of the Midwest Operations was $3 million. We also expect that the divestiture of our Paperboard Operations would result in estimated annual improvements in EBITDA of $2 million going forward.

The East Papers operations ran well with production volumes only slightly below the 2004 levels. Prices for fine papers, which represent a majority of the volume, were relatively flat whereas coated and uncoated groundwood were up 12% and 6% respectively. However, continued pressures from high fibre and energy costs resulted in significantly lower EBITDA.

The paper mill at Gorham increased total production of fine paper and towel by approximately 4% running all five paper machines at the facility for the full year of 2005. Average prices for fine paper, which represents the majority of the production, were flat whereas average towel prices increased approximately 9%. The increases in energy and wood costs served to offset the higher volumes and cost reductions achieved in 2005.

Pulp

Our internal hardwood kraft fibre requirements are met from Berlin, and the Thurso pulp mill sells substantially all of its production on the open market. Our market pulp production in 2005 increased 9% over 2004 when we took seven weeks of downtime due to weak markets. Total shipments in 2005 were 16% higher than 2004.

Average pulp prices achieved were approximately 9% higher compared to 2004, which contributed to the improvement in the operating results. However, EBITDA for the pulp operations was still negative at $15 million, compared to negative EBITDA of $27 million in 2004, as a result of significantly higher costs and the impact of the Canadian dollar. The continued pressures from the stronger Canadian dollar, increasing input costs and significant worldwide pulp capacity additions has affected the expected long-term profitability of our Thurso pulp mill. The Company performed an impairment review as a result of these factors that indicated that the carrying amount of the assets may not be recoverable. The Company recorded an impairment charge of $40 million against the assets of that operation in the second quarter of 2005.

Lumber

The sawmills in Maine and New Brunswick produce lumber and supply approximately 50% of the chips required annually by the sulfite pulp mill at Edmundston. Year-over-year, the decline in average lumber prices was approximately 10%. The lower lumber prices resulted in an $11 million decrease in sales, as compared to 2004. The declining prices, higher wood costs and the stronger Canadian dollar led us to take market-related downtime of one month at our two Canadian sawmills in the fourth quarter of 2005. The downtime affected our lumber shipments in the fourth quarter, which were down 25% compared to the same quarter of 2004. Lumber shipments in the first three quarters of 2005 were comparable to the same period of 2004. At the same time, rising wood costs at all of our sawmills resulted in increased costs compared to 2004. These negative trends were partially offset by our margin improvement initiatives and the positive impact of lower lumber duties. EBITDA from our lumber operations fell from $22 million in 2004 to $6 million in 2005. Our Canadian sawmills paid $3 million of anti-dumping duties in 2005 compared to $6 million in 2004.

In total, the Paper segment generated negative EBITDA of $8 million in 2005 compared to negative $9 million in 2004. Production volumes in the Paper segment in 2005 and 2004 were as follows:

Production (000's tons except as noted)	**2005**	2004
Uncoated freesheet	**459**	556
Uncoated groundwood paper	**115**	117
Coated groundwood paper	**65**	70
Paperboard	**46**	58
Towel	**38**	37
Pulp (000 tonnes)	**369**	337
Lumber (MMfbm)	**413**	441

Timber Segment

($millions)	**2005**	2004
Net sales	**$ 74**	$ 85
EBITDA	**12**	11
Depreciation	**1**	1
Capital investments	**—**	1

The Timber segment includes freehold land in Maine (approximately 237,000 acres) and New Brunswick (approximately 765,000 acres) and Crown licenses in New Brunswick (approximately 1,314,000 acres). The Company sold its Maine timberlands in April 2005 and its New Brunswick timberlands in January 2006. Concurrent with the sales of those assets, the Company secured its long-term fibre supply through 20 year fibre supply agreements, which allow Fraser Papers to purchase, at market prices, substantially the same volumes of wood as its historical usage from the sold lands. The Company expects to continue to have significant cash flows related to the sold operations as a result of wood purchases and cash distributions from the retained interests in Acadian Timber Income Fund.

Markets

Softwood sawlog markets were strong in the first half of 2005 but weakened in the second half of the year as lower lumber prices caused some sawmills to take downtime, affecting demand from sawmills. Pulpwood demand was softer in 2005 compared to 2004 as a number of pulp producers in our operating region announced permanent or temporary closures of their facilities. Prices were marginally lower in 2005, mostly as a result of product mix.

In 2004, the log supply to sawmills and pulp mills in Maine and New Brunswick was tight due to an ongoing shortage of contractor capacity and the impact of reduced provincial cutting allocations in the province of Quebec. The reduced provincial cutting allocations resulted in increased fibre flows to mills in Quebec from timberlands in Maine and New Brunswick.

Operations

EBITDA for Timber was $12 million in 2005 compared to $11 million in 2004. In 2005, total shipments were 2.6 million cubic metres, as compared to 2.9 million cubic metres in 2004.

SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

In preparing our financial statements, we 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 a period. Significant estimates include the determination of the carrying value and useful lives of property, plant and equipment and provisions for employee future benefits. Actual results could differ from those estimates.

The impairment charge booked against the assets of the Thurso pulp mill in 2005 is based on significant estimates due to the inherent uncertainty in predicting long-term cash flows, exchange rates and commodity prices. These estimates may be materially different from actual future cash flows due to a variety of factors including fluctuations in commodity prices and exchange rates.

Revenue recognition

Net sales are net of freight costs, commissions and discounts and rebates and are recognized when the title and risks of ownership pass to the purchaser. This is generally 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.

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
Sawmills 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 periodically assessed to ensure that they continue to approximate the useful lives of the related assets.

Financial Instruments

We use derivative financial instruments solely for the purpose of managing our 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.

LIQUIDITY AND CAPITAL RESOURCES

During 2005 Fraser Papers issued $150 million of senior unsecured notes, due in 2015. Proceeds of the issuance of senior unsecured notes were used, in part, to repay $75 million of debt owing to Brookfield.

The Company has a committed revolving credit facility of $50 million. This facility matures in June 2007. Borrowings under this facility are secured by a first charge against accounts receivable and inventory. At December 31, 2005, $35 million of this facility was utilized in the form of letters of credit, as compared to $32 million in 2004.

At the time of the Arrangement, Norbord continued to provide guarantees for certain obligations of Fraser Papers under a financial commitments agreement (the "FCA"). These guarantees were previously obligations of the Division. At December 31, 2005, the maximum potential amount of the obligations guaranteed was estimated to be $13 million.

Under the initial terms of the FCA, Fraser Papers agreed to provide letters of credit or other acceptable collateral to secure any guarantees outstanding on December 27, 2005. During 2005, the FCA was amended such that Fraser will be required to provide letters of credit or other acceptable collateral to secure any guarantees outstanding on December 27, 2006.

Cash flow from operations before changes in working capital amounted to a use of cash of $25 million, compared to positive cash flows of $14 million in 2004, mainly as a result of a $16 million decrease in EBITDA and the changes in pension funding and expense. Pension funding less pension expense amounted to a $21 million decrease in cash in 2005 as compared to $2 million in 2004.

Changes in working capital consumed $20 million in cash during the year, as compared to a use of cash of $83 million in 2004. After adjusting for the sale of our Midwest Operations, the increase in working capital in 2005 was mainly the result of higher inventories and a decrease in accounts payable. The increase in inventories is predominantly the result of the build-up of sawtimber inventories at our Canadian sawmills during the fourth quarter shutdown. We continued to purchase wood during this period to ensure appropriate supply in 2006. For the year ended December 31, 2004, the significant use of cash due to working capital was predominantly the result of the discontinuance of the sale of accounts receivable to a wholly-owned affiliate of Norbord prior to the Arrangement.

Sales of assets generated total cash of $85 million.

Fraser Papers capital spending in 2005 was $49 million, up significantly from the $7 million spent in 2004. In 2005 we purchased a cogeneration plant at Berlin-Gorham for $34 million. Previously, we were purchasing all of the energy produced by this plant. In addition, we spent $4 million to overhaul our cogeneration plant in Edmundston, New Brunswick. The remainder of the capital expenditures of $11 million incurred in the year represent the acquisition of equipment previously under lease and other sustaining capital expenditures. At year end 2005, there are no significant commitments to projects in progress. All of the 2004 capital program was used for maintenance of the business. We expect our capital expenditures in 2006 to be focused on maintenance of business projects. We will also consider any acquisitions which would complement our current portfolio of assets.

At December 31, 2005, Fraser Papers' cash and cash equivalents amounted to $75 million, resulting in net debt of $76 million, representing 15% of net debt plus equity as compared to 8% at the end of 2004. We expect to generate net pre-tax cash proceeds of approximately $94 million on the sale of our New Brunswick timberlands.

At December 31, 2005, Fraser Papers had loss carry-forwards for income taxes of $15 million in the United States and CAD$24 million in Canada. The tax benefit of losses in the U.S. have not been reflected in the financial statements as it is not more likely than not that these losses will be utilized. Loss carry-forwards will be available to reduce income taxes otherwise payable in future years.

Fraser Papers currently has significant cash balances and available liquidity under credit lines to support growth, weather any downturns and pursue its business plan.

Contractual Obligations

The following table presents the total contractual obligations for which cash flows are fixed or determinable as of December 31, 2005:

($millions)	Total	Less than one year	One to three years	Four to five years	After five years
Long-term debt	**$ 151**	$ 1	$ —	$ —	$ 150
Operating leases	**9**	3	5	1	—
Purchase obligations	**79**	33	27	12	7
Total contractual obligations	**$ 239**	$ 37	$ 32	$ 13	$ 157

Obligations under operating leases include future payments for warehouse and other office facilities, and equipment leases. The purchase obligations are commitments for the purchase of raw materials, primarily softwood kraft pulp, and energy.

Asset Retirement Obligations

Asset retirement obligations relate primarily to closure costs and post-closure maintenance costs for landfills in the Paper segment. 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 $25 million which have been discounted at an average rate of 8%. Total expense for the year related to asset retirement obligations was $1 million, unchanged from 2004. 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.

Defined Benefit Pension Plans

Our obligations under our defined benefit pension plans are determined periodically through actuarial valuations, which are the basis for calculating pension expense. At December 31, 2005, defined benefit pension plan assets were $415 million up from $390 million in 2004, while the accrued benefit obligations of $590 million were also higher than the $498 million obligations in 2004. At December 31, 2005, unfunded liability was $175 million, a marked deterioration compared to the $108 million of unfunded liability at December 31, 2004. The increase of $67 million was the result of changes in actuarial assumptions. The use of lower discount rates in the actuarial valuations of the liability resulted in a $37 million increase in the obligation. The use of updated mortality tables resulted in an approximately $30 million increase in the obligation. The funded status of our defined benefit pension plans is 70% at the end of 2005 compared to 78% in 2004.

Defined benefit pension expense of $14 million was below the $15 million recorded in 2004 primarily due to the divestiture of the Midwest Operations. Funding for the year was $30 million, up substantially from the $20 million funded in 2004. Our defined benefit pension plans are funded in accordance with all applicable regulatory requirements. Employer contributions are expected to increase as the impact of declining discount rates has negatively affected our projected benefit obligation.

The assumed return on assets is 8% 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 for the accrued benefit obligations is 5.14%, as compared to 5.75% in 2004, and is based on the market yield of high quality corporate bonds of similar duration to the pension plan liabilities. Sensitivity to a 1% decrease in these two key assumptions is estimated as follows:

	Impact Dec. 31, 2005 Unfunded Liability	Impact on 2005 Pension Expense
Return on assets	None	$4 million increase
Discount rate	$68 million increase	$3 million increase

Our obligations under our 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, 2005, the accrued benefit obligations of these plans were $64 million compared to $66 million at the end of 2004.

Plan amendments and curtailment gains from divested operations resulted in a post-retirement benefit income of $1 million for the year as compared to an expense of $6 million in 2004. Payments under these plans were $4 million in 2005 and $3 million in 2004.

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 our future plan assets, accrued benefit obligations, and the expenses and contributions associated with our employee benefit plans.

OFF-BALANCE SHEET ARRANGEMENTS

We have no material off-balance sheet arrangements.

COMMON SHARES

At the time of the Arrangement, 30,111,976 common shares were distributed to shareholders of Norbord. There were no other issuances of common shares during 2004. In 2005, the Company repurchased a total of 602,100 shares, or approximately 2% of the outstanding shares, at a weighted-average price per share of CAD$12.79 for a total consideration of $6 million. The transaction resulted in a decrease in common stock of $10 million. As the purchase price was below the stated value of the common shares, the transaction resulted in contributed surplus of $4 million.

The Board of Directors approved a share repurchase program in November 2005, whereby we may purchase on the Toronto Stock Exchange up to 1.5 million common shares, representing 5% of the total shares outstanding. Purchases may be made between November 2005 and November 2006. No other shares were repurchased in 2005.

Common Share Information	**December 31, 2005**	December 31, 2004
Shares outstanding	**29,509,876**	30,111,976
Book value	**$15.11**	$15.97
Market price at year-end	**CAD$10.01**	CAD$15.56
Market price at March 7, 2006	**CAD$7.49**	

There have been no changes in common shares outstanding up to the date of this MD&A.

DIVIDENDS

We paid no dividends in 2005. 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 2004, the Board of Directors granted certain officers of the Company stock options to purchase 215,000 shares of the Company at CAD$16.45. In the first quarter of 2005, the Board approved the issuance to certain executives of 30,000 options with a strike price of CAD$14.59. In 2004 and 2005, we recognized less than $1 million in expense related to stock options.

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 may be subject to vesting periods. Payments under the plans are made in cash only. The total number of deferred stock units outstanding at December 31, 2005 was 211,815.

TRANSACTIONS WITH RELATED PARTIES

We purchase certain electricity and fibre from Brookfield. During 2005, we purchased $8 million of electricity and $10 million of fibre from Brookfield. In 2004, we purchased $10 million of electricity and $5 million of fibre from Brookfield.

During 2005, Fraser Papers exercised its option to acquire a 25-megawatt cogeneration plant in Berlin, New Hampshire for $34 million from Brookfield.

Fraser Papers has invested in convertible, term, preferred units in Katahdin, a wholly-owned subsidiary of Brookfield. Katahdin operates two paper mills in Maine. The units offer us the potential to participate in the growth and financial returns of Katahdin. Two paper machines were restarted at Katahdin in 2003 and one paper machine in 2004. We have managed the assets since start-up, providing sales, marketing and operating services in return for a management fee. During 2005, we earned $7 million in management fees compared to $5 million in 2004.

In 2005, our option to acquire Katahdin expired. Brookfield has extended the option to June 2006. As a result, we will make a decision on this acquisition in the first half of 2006. The acquisition of Katahdin will be subject to approval by the members of the Board of Directors who are not related to Brookfield, receipt of a fairness opinion, and other regulatory approvals.

Under the Arrangement, we have contracted Norbord to provide certain administrative services for a fee on an interim basis. In 2005 and 2004, these fees amounted to less than $1 million. Prior to the Arrangement, Norbord provided certain taxation, treasury, lumber sales and collection agent services for us. Total amounts paid for these services amounted to less than $1 million in 2004.

MARKET RISKS AND UNCERTAINTIES

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

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 2005, the following table shows the approximate annualized impact on after tax earnings of changes in product prices.

	Sensitivity Factor	Impact on Earnings *($millions)*	Impact on EBITDA *($millions)*	Average Mill Nets Q4, 2005
Uncoated freesheet	$25 per ton	$ 7	$ 11	$ 878
Groundwood paper	$25 per ton	$ 3	$ 5	$ 769
Market pulp	$25 per tonne	$ 2	$ 3	$ 448
Lumber	$10 per Mfbm	$ 3	$ 4	$ 318

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 we do. 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.

Our policy is to hedge all significant balance sheet foreign exchange exposures. We may hedge a portion of net Canadian dollar denominated cash flows for periods up to three years in order to reduce the potential negative effect of a strengthening Canadian dollar versus the U.S. dollar.

In 2005, we were negatively impacted by the continued strengthening of the Canadian dollar, with an average exchange rate, relative to the U.S. dollar, of US$0.83 compared to US$0.77 in 2004 on our approximately CAD$300 million net Canadian dollar cash flows. We estimate that each U.S. one cent change in the value of the Canadian dollar impacted annualized after tax earnings by approximately $3 million in 2005. We estimate that the actual impact of the strengthening Canadian dollar amounted to an $18 million decrease in EBITDA compared to 2004.

There were no Canadian dollar cost hedges outstanding during 2005 or 2004.

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 incur, and expect to continue to 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 significantly increased capital expenditures which would reduce the funds otherwise available for operations, capital expenditures, future business opportunities or other purposes. For example, the ratification of the Kyoto Protocol by Canada may result in lower limits for the emission of carbon dioxide and other greenhouse gases, which would require us to regulate production or invest in the installation of additional pollution control equipment.

Furthermore, failure by us to comply with applicable environmental and safety laws and regulations, and the permit requirements related thereto, could result in civil or criminal fines or penalties or enforcement actions, including regulatory or judicial orders enjoining or curtailing operations or requiring corrective measures, installation of pollution control equipment or remedial actions, any of which could result in significant capital expenditures or reduced results of operations.

SUBSEQUENT EVENTS

On March 7, 2006, Fraser Papers announced a strategic decision to permanently close its pulp mill located in Berlin, New Hampshire. The strategic decision, supported by the Board, is aimed at reducing the Company's exposure to market pulp. The adjacent paper mill in Gorham, New Hampshire will operate on purchased fibre. The strategic decision will allow the Company to focus its pulp production at the Company's pulp mill in Thurso, Quebec and will result in the Company purchasing pulp for its paper mills as opposed to selling excess pulp production into the market.

The closure of the pulp mill is expected to result in severance and other costs of $3 million. As at December 31, 2005, property, plant and equipment includes $40 million, and other assets include $8 million related to this operation. The Company is currently evaluating alternatives for these assets and expects to record a material, non-cash impairment charge related to these assets in the first quarter of 2006.

Subsequent to December 31, 2005, Smart Papers LLC, in which Fraser Papers holds a 40% equity interest (the "Investment"), announced the shut down of one of its manufacturing facilities. Based on the information currently available to the Company, the Company does not believe that there is an other-than-temporary decline in the value of the Investment. However, should new information become available that suggests that an other-than-temporary decline in the value of the Investment exists, there could be a material impairment to the carrying value of the Investment.

CONTROLS AND PROCEDURES

Fraser Papers is committed to providing timely, accurate and balanced disclosure of all material information about the Company. As at December 31, 2005, Fraser Papers' management evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined under the rules of Canadian securities regulatory authorities. This evaluation was performed under the supervision and with the participation of the Chief Executive Officer (CEO) and the Chief Administrative Officer (CAO) and was reviewed by our newly appointed Chief Financial Officer ("CFO"). It is our conclusion that such disclosure controls and procedures were effective as at December 31, 2005.

Disclosure controls are procedures designed to ensure that information required to be disclosed in reports filed with securities regulatory authorities is recorded, processed, summarized and reported on a timely basis, and is accumulated and communicated to the Company's management, including the CEO, the CAO and the CFO, as appropriate, to allow timely decisions regarding required disclosure.

FORWARD-LOOKING INFORMATION

This report contains forward-looking information and statements relating but not limited to, operations, anticipated or prospective financial performance, results of operations, business prospects and strategies of Fraser Papers. Examples of such statements included in this document include, but are not limited to, the expected improvements in results following divestitures and other initiatives, expected changes in significant cash flows, strategic and operational intentions and others.

Forward-looking information typically contains statements with words such as “consider”, “anticipate”, “believe”, “expect”, “plan”, “intend”, “likely” or similar words suggesting 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 could impact our business and our future performance are discussed in our Annual Information Form as well as Fraser Papers’ Annual Report and other filings with Canadian securities regulatory authorities. The Company 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 the Company’s views and the actual outcome is uncertain.

OUTLOOK

In 2005, the paper industry experienced significant cost pressures from the rising prices of fibre, energy and chemicals. The continued strength of the Canadian dollar also affected a number of Canadian operations. Those developments have resulted in capacity reductions and announcements, especially in uncoated freesheet grades. These closures may result in an improved pricing environment for uncoated freesheet grades in 2006, to counter the soft demand trends experienced in 2005.

Uncoated freesheet demand fell 4% in 2005 according to industry publications. Electronic substitution and increased usage of hi-bright uncoated groundwood papers have been the major contributors to declining demand. Benchmark pricing for commodity uncoated freesheet, which remained flat in the fourth quarter at $695 per ton, has decreased by 10% over 2004 levels. Less than 25% of our uncoated freesheet production is in commodity grades. We believe our specialty grades are not as susceptible to changes in demand and pricing as commodity grades. We anticipate flat pricing for commodity uncoated freesheet going into 2006. We will continue our efforts to increase our mill net selling prices as a result of aggressive mix improvements.

Demand for uncoated groundwood papers improved 3% in 2005 specifically in the hi-bright groundwood grades, directory and super-calendered grades. We anticipate slightly improved pricing in 2006 mostly as we continue to improve our product mix and increase volumes in the hi-bright groundwood grades.

Demand for coated groundwood declined by 3% in 2005 according to major industry publications. However, disruptions in the marketplace with the Finnish paper industry lockout and a strike at a major producer decreased supply by 7%. Improved pricing in 2005 was mostly the result of those disruptions. We anticipate a marginal decline in pricing in 2006 as supply and demand become more balanced.

Hardwood kraft pulp prices were generally stronger in 2005 relative to 2004. We expect strong demand for hardwood grades, particularly from Asia. However, North American mills compete directly with lower cost capacity in Asia and Latin America. We expect pulp prices to remain flat in 2006.

In the second half of 2005, benchmark lumber prices experienced a decline from the record highs in 2004 and early 2005. Despite solid housing start activity, the increased supply has moderated the market. In 2005, benchmark pricing (ESP Boston, 2x4) has ranged from a low of $371 to a high of $466 and ended at $394 in December. A strong Canadian dollar exacerbates the impact for Canadian producers. We anticipate lower housing starts over the next few years which could lead to lower demand for lumber products.

Following the sale of our New Brunswick timberlands in January 2006, we will have completed the disposition of our freehold timberlands and surfaced considerable value for shareholders. Proceeds from these transactions will be used to grow our business selectively and on a value basis.

In 2006, we will continue to focus our paper operations on specific products and grades where we can develop or maintain sustainable advantage in our competitive markets. Over the past year, we made considerable progress in this regard and our specialty papers now represent approximately 75% of our uncoated freesheet paper sales, up from 72% in 2004. Considering the difficult market environment in which we currently operate, we must continue to employ an extremely cost-conscious, results oriented focus in our daily operations. The goal of the 2006 margin improvement program is to deliver $30 million in benefits compared to 2005.

ADDITIONAL INFORMATION

Additional information relating to the Company, including information contained in our annual information form, can be obtained without charge on our web site at *www.fraserpapers.com* or on SEDAR at *www.sedar.com*.

DEFINITIONS

EBITDA is earnings from continuing operations before interest, income taxes, depreciation and amortization and restructuring charge. EBITDA is presented as a useful indicator of our operating performance. We interpret EBITDA trends as an indicator of relative operating performance.

Net debt is long-term debt including the current portion and bank advances less cash and short-term notes, and is provided as a useful indicator of our financial position.

Free cash flow is defined as cash provided by operations plus the net change in non-cash working capital balances less total capital investments and is provided as a useful measure of our liquidity.

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 our financial leverage.

EBITDA	Year Ended December 31,	
($millions)	**2005**	2004
Loss	**$ (29)**	$ (43)
Add: Interest expense	**12**	7
Add: Fees on sale of accounts receivable	**—**	2
Less: Interest income	**(3)**	(1)
Less: Income tax recovery	**(26)**	—
Less: Gain on sale of Maine timberlands	**(46)**	—
Add: Impairment losses	**41**	—
Add: Depreciation	**39**	48
Add: Loss of equity-accounted investee	**8**	—
Add: Restructuring charge	**8**	7
EBITDA	**$ 4**	$ 20

Net Debt	Year Ended December 31,	
($millions)	**2005**	2004
Long-term debt	**$ 150**	$ 1
Current portion of long-term debt	**1**	40
Cash and cash equivalents	**75**	—
Net debt	**$ 76**	$ 41

Free Cash Flow	Year Ended December 31,	
($millions)	**2005**	2004
Cash provided by operating activities	**$ (45)**	$ (69)
Investing activities	**21**	(5)
Free cash flow	**$ (24)**	$ (74)

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 the 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.

Dominic Gammiero
President and Chief Executive Officer

Peter Gordon
Senior Vice President, Finance and Chief Financial Officer

February 6, 2006

Auditors’ Report

To the Shareholders of Fraser Papers Inc.

We have audited the consolidated balance sheets of Fraser Papers Inc. as at December 31, 2005 and 2004 and the consolidated statements of operations and deficit and Norbord’s net investment and the consolidated statements of cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these 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 Fraser Papers Inc. as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants

Toronto, Canada
February 6, 2006 *(except as to notes 3 and 21, which are as of March 7, 2006*

Consolidated Balance Sheets

As at December 31 *(US$ millions)*	**2005**	2004
Assets		
Current assets		
Cash and cash equivalents	**$ 75**	$ —
Accounts receivable *(note 7)*	**109**	119
Inventory *(note 8)*	**113**	128
Future income taxes *(note 14)*	**10**	10
	307	257
Property, plant and equipment *(note 9)*		
Paper	**340**	436
Timber *(note 19)*	**19**	52
Other assets *(notes 3 and 10)*	**122**	25
	$ 788	$ 770
Liabilities, Norbord's Net Investment and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	**$ 90**	$ 110
Current debt *(note 11)*	**1**	40
	91	150
Long-term debt *(note 11)*	**150**	1
Other liabilities *(notes 12 and 13)*	**55**	65
Future income taxes *(note 14)*	**46**	73
Shareholders' equity *(note 15)*	**446**	481
	$ 788	$ 770

(See accompanying notes)

On behalf of the Board,

Paul Gagné, CA
Audit Committee Chair

Dominic Gammiero
President and Chief Executive Officer

Consolidated Statements of Operations and Deficit and Norbord's Net Investment

Years ended December 31 *(US$ millions, except per share amounts)*	**2005**	2004
Net sales	**$ 918**	$ 996
Earnings before the following		
Paper	**(8)**	9
Timber	**12**	11
	4	20
Gain on sale of Maine timberlands *(note 2)*	**46**	—
Impairment charges *(notes 4 and 5)*	**(41)**	—
Loss of equity-accounted investee *(note 3)*	**(8)**	—
Restructuring charges *(note 6)*	**(8)**	(7)
Interest Income	**3**	1
Fees on sale of accounts receivable *(note 7)*	**—**	(2)
Interest expense *(note 11)*	**(12)**	(7)
Earnings (loss) before depreciation and income taxes	**(16)**	5
Depreciation	**(39)**	(48)
Income tax recovery *(note 14)*	**26**	—
Loss	**$ (29)**	$ (43)
Loss per share (basic and diluted)	**$ (0.98)**	$ (1.43)
Deficit and Norbord's Net Investment		
Balance, beginning of year	**$ (19)**	$ 548
Loss	**(29)**	(43)
Contribution by Norbord	**—**	103
Future income taxes *(note 14)*	**—**	(44)
Issuance of note payable to Norbord *(note 11)*	**—**	(83)
Transfer to share capital	**—**	(500)
Balance, end of year	**$ (48)**	$ (19)

(See accompanying notes)

Consolidated Statements of Cash Flows

Years ended December 31 *(US$ millions)*	**2005**	2004
Cash provided by (used for):		
Operating Activities		
Loss	**$ (29)**	$ (43)
Items not affecting cash:		
Depreciation	**39**	48
Future income taxes *(note 14)*	**(27)**	(2)
Gain on sale of Maine timberlands *(note 2)*	**(46)**	—
Impairment charges *(notes 4 and 5)*	**41**	—
Loss of equity accounted investee *(note 3)*	**8**	—
Employment benefits plan expense *(note 13)*	**13**	21
Non-cash foreign exchange	**3**	8
Amortization of deferred start-up costs	**4**	4
Employment benefit plan funding *(note 13)*	**(34)**	(23)
Other items	**3**	1
	(25)	14
Net change in non-cash working capital balances *(note 16)*	**(20)**	(83)
	(45)	(69)
Investing Activities		
Capital investments		
Paper	**(49)**	(6)
Timber	**—**	(1)
Investment in lease *(note 18)*	**(15)**	—
Proceeds on sale of Maine timberlands *(note 2)*	**78**	—
Proceeds on sale of paperboard operations and other assets *(note 4)*	**7**	—
Other	**—**	2
	21	(5)
Financing Activities		
Contribution by Norbord	**—**	101
Issuance of long-term debt *(note 11)*	**185**	83
Repayment of long-term debt *(note 11)*	**(75)**	(126)
Debenture issue costs *(note 10)*	**(5)**	—
Share repurchases *(note 15)*	**(6)**	—
	99	58
Increase (decrease) in cash and cash equivalents	**$ 75**	$ (16)

(See accompanying notes)

Notes to the Consolidated Financial Statements

(US$ millions)

In these notes "Fraser Papers" means Fraser Papers Inc. and all of its consolidated subsidiaries and affiliates for periods subsequent to June 30, 2004 and the Fraser Papers division of Norbord for periods up to June 30, 2004, and "Company" means Fraser Papers Inc. as a separate corporation. "Norbord" means Norbord Inc. or any of its consolidated subsidiaries. "Brookfield" means Brookfield Asset Management Inc, formerly Brascan Corporation, (a related party by virtue of a significant shareholding in the Company) or any of its consolidated subsidiaries.

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

On June 30, 2004, Nexfor Inc. completed a reorganization whereby, among other things it transferred its interest in its paper, sawmill and timber assets to Fraser Papers and then distributed the shares in the Company to its shareholders. Nexfor Inc. then changed its name to Norbord Inc. Fraser Papers became a separate publicly traded company governed by the Canada Business Corporations Act ("CBCA"). This distribution was affected by way of a plan of arrangement under the CBCA (the "Arrangement"). Norbord common shareholders effectively received one share of the Company, for each five shares of Norbord held.

These consolidated financial statements include the accounts of the Company and all of its subsidiaries and have been prepared using the same accounting policies and methods as the combined financial statements of the Fraser Papers division of Norbord ("the Division") for the period from January 1, 2004 to June 30, 2004. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

For periods prior to June 30, 2004 the consolidated financial statements were prepared from the books and records of the Division. The financial results of the Division include the administrative costs associated with managing the Paper and Timber segments of Norbord. These include office rents, selling costs and divisional personnel and travel costs. Certain expenses in the consolidated financial statements for periods prior to June 30, 2004 represent inter-company allocations for services, such as tax and treasury, provided by Norbord.

Income taxes for periods prior to June 30, 2004 have been recorded at statutory rates based on income as reported in the consolidated statements of operations as though the Division was a separate tax paying entity. Income taxes payable in respect of the components which were not historically separate tax paying legal entities have been included in Norbord's net investment. Future income taxes have been presented in the consolidated balance sheet for each temporary difference between the financial reporting and tax bases of the assets and liabilities. In addition, future tax assets have been recognized to the extent that they would have been realized as though the Division was a separate tax paying entity.

Earnings per share for the period from January 1, 2004 to June 30, 2004 are based on the assumption that the 30,111,976 common shares issued as a result of the Arrangement were issued and outstanding during that period.

Norbord's net investment in the Division included certain interest-bearing loans which were repaid at the time of the Arrangement. Interest expense recorded in the consolidated statements of operations for periods prior to June 30, 2004 includes interest expense associated with these loans.

As a result of the basis of presentation described above, the consolidated statements of operations for periods prior to June 30, 2004 may not necessarily be indicative of the revenues and expenses that would have resulted had the Division operated as a stand-alone entity during those periods.

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 consists of cash in the bank and short-term deposits with a term to maturity of less than ninety days. Cash and cash equivalents are recorded at cost, which approximates their 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 includes all direct production costs and an allocation of overhead costs incurred at production facilities, and 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
Sawmills 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

Silviculture costs on owned timberlands are capitalized. Depletion of timber is recorded in a systematic manner based on the utilization of timber resources. Interest costs on 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.

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 the final 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 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 in the Paper segment. 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 possible new regulations affecting these closures.

Revenue Recognition

Net sales are net of freight costs, commissions, discounts and rebates to customers 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 standard industry terms and in some cases by contract. Revenue is not recognized prior to completion of all terms.

Translation of Foreign Currencies

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

Canadian dollar-denominated monetary assets and liabilities 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. Gains or losses on transactions that hedge these items are also included in the consolidated statements of operations.

Gains or losses on derivative financial instruments that serve to hedge future Canadian dollar-denominated costs are recognized at their settlement dates and are included in cost of sales.

Stock-based Compensation

The Company has a stock-based compensation plan, which is described in Note 15. 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 estimated life 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 can be 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 recorded based on the current market price of the vested units.

Financial Instruments

The fair values of financial instruments approximate their carrying values, except where disclosed elsewhere in these notes. Fair values disclosed are determined using actual quoted market prices or, if not available, indicative prices based on similar publicly traded instruments.

Fraser Papers uses derivative financial instruments to manage its foreign currency and commodity price exposures. Fraser Papers does not use derivative financial instruments for speculative purposes. All hedging relationships, risk management objectives and hedging strategies are formally documented and periodically assessed as to whether changes in the value of derivatives are highly effective in offsetting changes in the fair values or cash flows of hedged items.

Realized and unrealized gains and losses on derivative financial instruments designated as hedges for accounting purposes are treated in the same manner as gains and losses on the underlying item being hedged.

Gains and losses on forward foreign exchange contracts that serve to hedge Canadian dollar-denominated net monetary assets or liabilities are recognized in cost of sales, with the fair value of the forward foreign exchange contract accrued in other assets. These contracts are generally short-term in nature. As such, any forward premium or discount is recognized at maturity of the contract in cost of sales.

Gains or losses on futures or swap contracts that serve to hedge the future selling prices for certain of our products are not recognized in net sales until the occurrence of the hedged transaction when the products are sold. The fair value of a hedging instrument that has been recognized in net sales and has not yet settled is accrued in accounts receivable or accounts payable and accrued liabilities.

NOTE 2. SALE OF MAINE TIMBERLANDS

On May 19, 2005 Fraser Papers completed the sale of approximately 240,000 acres of timberlands in Maine (the "Maine Timberlands") for net proceeds of $78. The sale resulted in a pre-tax gain of $46. Fraser Papers has entered into an agreement with the purchaser whereby Fraser Papers has the right to purchase fibre from the purchaser for 20 years at prevailing market prices. The amount of fibre available to Fraser Papers under the agreement will approximate its historical usage from the Maine Timberlands.

NOTE 3. SALE OF MIDWEST OPERATIONS

On February 18, 2005, Fraser Papers sold a production facility in Park Falls, Wisconsin, a leased distribution facility in West Chicago, Illinois and related net assets (collectively, the "Midwest Operations"). The results of operations and cash flows of the Midwest Operations are included in the consolidated financial statements up to the date of sale. Results of operations for the first quarter of 2005 included net sales of $17, loss before interest, income taxes and depreciation of $3 and depreciation expense of $1.

As consideration for these net assets, Fraser Papers received a 40% common equity interest in Smart Papers LLC (the "Investment"), the purchaser of the Midwest Operations. The transaction has been accounted for at fair value with fair value based on the value of the Investment and there was no resulting gain or loss. The agreement governing the sale of these assets includes standard representations, warranties and indemnities for transactions of this nature. However, any breach of any warranty or claim under an indemnity could result in an increase or decrease in Fraser Papers' percentage of ownership.

At December 31, 2005 the net book value of the Investment, after losses of equity accounted investee, including amortization of fair value increments, is $74 and is included in other assets (Note 10).

The net assets sold to Smart Papers LLC consisted of:

Operating working capital	$ 23
Property plant and equipment	61
Other liabilities	(2)
	$ 82

Certain liabilities of the Midwest Operations were retained by Fraser Papers and consist primarily of employment, pension and post-retirement obligations related to past service. In addition, the Company has effectively provided financial guarantees for certain obligations of the Midwest Operations under operating leases, purchase contracts and landfill operations. Management estimates that these financial guarantees total $15.

Subsequent to December 31, 2005, Smart Papers LLC shut down one of its manufacturing facilities. Based on the information currently available to the Company, the Company does not believe that there is an other-than-temporary decline in the value of the Investment. However, should new information become available that suggests that an other-than-temporary decline in the value of the Investment exists, there could be a material impairment to the carrying value of the Investment.

NOTE 4. SALE OF PAPERBOARD OPERATIONS AND OTHER ASSETS

On October 4, 2005, Fraser Papers sold its paperboard operations (the "Paperboard Operations") for proceeds of $5. In addition, the Company sold two other non-core assets for total proceeds of $2. There were no gains recorded on these sales.

Prior to the sale of its Paperboard Operations, the Company recorded an impairment charge of $1 on the basis of receiving a firm offer to purchase the Paperboard Operations.

NOTE 5. IMPAIRMENT CHARGE FOR THURSO PULP MILL

During the second quarter of 2005, the Company recorded a pre-tax, non-cash impairment charge of $40 against the assets of its pulp mill in Thurso, Quebec. The Company performed an impairment review and considered the continued strength of the Canadian dollar, increasing input costs and significant worldwide pulp capacity additions, which have negatively affected the long-term profitability of this operation, to be indicators that the carrying amount of these assets may not be fully recoverable. As a result, the Company recorded an impairment charge equal to the amount by which the carrying value of the assets exceeded their fair value. The fair value of the assets was determined using a discounted cash flow analysis of the long-term projected operating results of the mill.

NOTE 6. RESTRUCTURING CHARGES

As a result of the sale of its Paperboard Operations, the Company reduced its workforce by 98 positions at its mill in Edmundston, New Brunswick. The elimination of these positions resulted in a restructuring charge of $8 consisting of severance and early retirement costs of $5 and a non-cash charge for pension and non-pension post-retirement benefits of $3.

In 2004, Fraser Papers recorded restructuring charges representing the costs associated with downsizing at a number of Fraser Papers' locations. The total charges relate to a workforce reduction of 190 positions and include severance, early retirement and other costs of $6 and non-cash pension and non-pension post-retirement benefits related charges of $1.

At December 31, 2005 restructuring reserves of $8 (2004 – $4) were included in accounts payable, accrued liabilities and other liabilities. Total charges of $4 were applied against the restructuring reserves in 2005.

NOTE 7. ACCOUNTS RECEIVABLE

Prior to the Arrangement, the Division sold a portion of its third party trade accounts receivable to a wholly-owned subsidiary of Norbord.

NOTE 8. INVENTORY

	2005	2004
Raw materials	**$ 32**	$ 32
Finished goods	**48**	63
Operating and maintenance supplies	**33**	33
	$ 113	$ 128

NOTE 9. PROPERTY, PLANT AND EQUIPMENT

At December 31, 2005, property, plant and equipment and related accumulated depreciation are as follows:

	Cost	Accumulated Depreciation	Net Book Value **2005**	2004
Pulp and paper mills	$ 941	$ (634)	**$ 307**	$ 397
Sawmills	113	(80)	**33**	39
Timber and timberlands	*40*	(21)	**19**	52
	$ 1,094	$ (735)	**$ 359**	$ 488

NOTE 10. OTHER ASSETS

At December 31, 2005, other assets consist of the following:

	2005	2004
Investment in Smart Papers *(note 3)*	**$ 74**	$ —
Investment in lease *(note 18)*	**14**	—
Investment in Katahdin Paper Company LLC *(note 18)*	**11**	11
Pension plans *(note 13)*	**11**	—
Deferred start-up costs	**8**	12
Debt issuance costs	**4**	—
Other	**—**	2
	$ 122	$ 25

Deferred start-up costs relate to Fraser Papers' Berlin-Gorham operation and are being amortized over three years.

Debt issuance costs relate to the issuance of $150 of 8.75% senior, unsecured notes and fees and expenses related to the revolving credit facility and are being amortized over the terms of these facilities (Note 11).

NOTE 11. DEBT

On March 17, 2005, the Company issued $150 senior, unsecured notes. The notes bear interest at 8.75% and are due in 2015. The indenture agreement governing the notes contains certain covenants, the more significant of which include restrictions on the incurrence of additional indebtedness, sale of assets, mergers, creation of liens, payment of dividends and repurchase of the Company's shares.

Fraser Papers has a committed revolving credit facility of $50. The facility matures in June 2007 and bears interest at market rates. Borrowings under the facility are secured by a first charge against accounts receivable and inventory. At December 31, 2005, $35 (2004 – $32) of this facility was utilized, all of which was in the form of letters of credit to certain creditors.

Current portion of long-term debt includes $1 of non-interest bearing debt which matures in 2006. The outstanding principal will be forgiven on May 1, 2006 if Fraser Papers continues to fulfill certain requirements.

At December 31, 2004, the Company's borrowings included $40 under an $83 revolving credit facility with Brookfield which bore interest at market rates. During the first quarter of 2005, the Company borrowed an additional $35 under the facility. On issuing the 8.75% senior, unsecured notes, the Company repaid all amounts outstanding under the facility and the facility was cancelled.

Total cash interest paid in 2005 was $7 (2004 – $7) including $1 paid to Brookfield (2004 – $1) and nil paid to Norbord (2004 – $6).

On June 30, 2004, the Company issued a note payable to Norbord for $83, as part of the Arrangement. On September 30, 2004, the Company entered into the $83 revolving credit facility with Brookfield and used the proceeds to repay the amounts owing Norbord.

NOTE 12. OTHER LIABILITIES

	2005	2004
Post-retirement benefit plans *(note 13)*	**$ 43**	$ 48
Pension plans *(note 13)*	**—**	4
Asset retirement obligations	**9**	10
Deferred revenue and other	**3**	3
	$ 55	$ 65

Asset retirement obligations relate primarily to closure costs and post-closure maintenance costs for landfills in the Paper segment. The obligations represent estimated future payments of $25 which have been discounted at an average rate of 8%. Total accretion expense for the year related to asset retirement obligations was $1 (2004 – $1). The decrease from disposed operations and expenses applied against the reserve amounts to $2. 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 13. EMPLOYEE BENEFIT PLANS

Pension Plans

Fraser Papers has a number of pension plans, participation in which is available to substantially all employees after periods of up to two years of continuous service. Fraser Papers' obligations under its defined benefit pension plans are determined periodically through the preparation of actuarial valuations, which are required every three years for Canadian plans and every year for U.S. plans. Information about these plans is as follows:

	2005	2004
Change in Accrued Benefit Obligation During the Year:		
Accrued benefit obligation, beginning of year	**$ 498**	$ 464
Employee contributions	**2**	2
Current service cost	**7**	7
Interest on accrued benefit obligation	**29**	28
Benefits paid	**(42)**	(34)
Net actuarial loss	**75**	7
Plan amendments	**10**	—
Divested operations *(notes 3 and 6)*	**(3)**	—
Foreign currency exchange rate impact	**14**	24
Accrued benefit obligation, end of year(1)	**$ 590**	$ 498
Change in Plan Assets During the Year:		
Plan assets, beginning of year	**$ 390**	$ 346
Actual return on plan assets	**26**	38
Employer contributions	**30**	20
Employee contributions	**2**	2
Benefits paid	**(42)**	(34)
Foreign currency exchange rate impact	**9**	18
Plan assets, end of year(1)	**$ 415**	$ 390
Reconciliation of Funded Status:		
Accrued benefit obligation	**$ 590**	$ 498
Plan assets	**415**	390
Accrued benefit obligation in excess of plan assets	**(175)**	(108)
Unamortized net actuarial loss	**185**	109
Unamortized prior service costs	**9**	4
Unamortized net transitional asset	**(8)**	(9)
Net accrued benefit asset (liability)	**$ 11**	$ (4)

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

The net actuarial loss of $75 is primarily the result of changes in actuarial assumptions. A reduction in the discount rate used to discount the accrued benefit obligations resulted in an actuarial loss of $37. A change to more current mortality tables resulted in an actuarial loss of $30.

	2005	2004
Components of Net Pension Expense:		
Current service cost	**$ 7**	$ 7
Interest on accrued benefit obligation	**29**	28
Actual return on plan assets	**(26)**	(38)
Net actuarial loss	**75**	7
Plan Amendments	**10**	—
Divested operations *(note 6)*	**3**	3
Difference between actual and expected return on plan assets	**(6)**	10
Difference between actual and recognized net actuarial loss	**(69)**	(2)
Difference between actual and recognized prior service costs	**(8)**	1
Amortization of net transitional asset	**(1)**	(1)
Net periodic pension expense	**$ 14**	$ 15
Significant Weighted-Average Actuarial Assumptions:		
Used in calculation of net periodic pension expense for the year:		
Discount rate	**5.75%**	6.09%
Expected long-term rate of return on plan assets	**8.00%**	8.00%
Rate of compensation increase	**3.75%**	3.84%
Used in calculation of accrued benefit obligation, end of year:		
Discount rate	**5.14%**	5.75%
Rate of compensation increase	**3.75%**	3.75%

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

Asset category:		
Equity investments	**73%**	72%
Fixed income investments	**27%**	28%
Total assets	**100%**	100%

Cost of sales includes $3 (2004 – $3) 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:

	2005	2004
Change in Accrued Benefit Obligation During the Year:		
Accrued benefit obligation, beginning of year	**$ 66**	$ 66
Current service cost	**1**	1
Interest on accrued benefit obligation	**3**	4
Benefits paid	**(4)**	(3)
Net actuarial loss	**10**	2
Plan amendment	**(13)**	(5)
Restructuring *(note 6)*	**—**	(1)
Foreign currency exchange rate impact	**1**	2
Accrued benefit obligation, end of year	**$ 64**	$ 66
Reconciliation of Funded Status:		
Accrued benefit obligation	**$ 64**	$ 66
Plan assets	**—**	—
Accrued benefit obligation in excess of plan assets	**(64)**	(66)
Unamortized net actuarial loss	**31**	22
Unamortized prior service cost	**(10)**	(4)
Net accrued benefit liability	**$ (43)**	$ (48)

	2005	2004
Components of Net Post-retirement Benefit Expense:		
Current service cost	**$ 1**	$ 1
Interest on accrued benefit obligation	**3**	4
Plan amendment	**(13)**	(5)
Net actuarial loss	**10**	2
Difference between actual and recognized net actuarial loss	**(9)**	(1)
Difference between actual and recognized prior service losses	**10**	5
Divested operations *(note 3)*	**(3)**	—
Net periodic post-retirement benefit expense (income)	**$ (1)**	$ 6
Significant Weighted-Average Actuarial Assumptions:		
Used in calculation of net periodic pension expense for the year:		
Discount rate	**5.75%**	6.17%
Rate of compensation increase	**3.75%**	3.92%
Used in calculation of accrued benefit obligation, end of year:		
Discount rate	**5.14%**	5.75%
Rate of compensation increase	**3.75%**	3.75%
Health care cost trend rate used in calculation of accrued benefit obligation, end of year:		
Initial rate	**10.00%**	10.62%
Ultimate rate	**5.00%**	5.00%
Year ultimate rate reached	**2014**	2012
Sensitivity to change in health care cost trend rate, for year ended December 31, 2005:	**1% increase**	1% increase
Impact on net periodic post-retirement benefit expense	**1**	1
Impact on accrued benefit obligation	**8**	8

NOTE 14. 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:

	2005	2004
Current tax expense	**$ (1)**	$ (2)
Future income tax recovery	**27**	2
Income tax recovery	**$ 26**	$ —

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

	2005	2004
Loss before income taxes	**$ (55)**	$ (43)
Tax recovery at combined statutory rates	**19**	15
Effect of:		
Rate differences on foreign activities	**1**	7
Foreign exchange and other	**8**	(1)
Change in valuation allowance	**(2)**	(21)
Income tax recovery	**$ 26**	$ —

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

	2005	2004
Benefit of tax loss carry forwards	**$ 14**	$ 5
Post-employment benefits	**12**	20
Other future income tax assets	**10**	10
Other future income tax liabilities	**(8)**	—
Property, plant and equipment	**(57)**	(93)
Future income taxes	**$ (29)**	$ (58)
Less: Valuation allowance	**(7)**	(5)
Future income taxes, net	**$ (36)**	$ (63)
Represented by:		
Current future income tax asset	**$ 10**	$ 10
Long-term future income tax liability	**(46)**	(73)
	$ (36)	$ (63)

The benefit of tax loss carry-forwards includes the benefit of $17 (2004 – $11) of net operating losses in the United States which expire in 2024. A valuation allowance of $7 (2004 – $5) has been provided against the benefit of these losses as it is not more likely than not that they will be realized. The Company has $21 of loss carry-forwards in Canada which expire in 2011.

Income or income-related taxes of $7 (2004 – $1) were paid during the year of which $6 are classified as income tax recoverable as at December 31, 2005 and are included in accounts receivable.

Under the Arrangement, the benefits associated with tax loss carry-forwards, investment tax credits and other temporary differences previously included in the accounts of the Division were transferred to Norbord. This resulted in a $44 increase in future income tax liabilities.

NOTE 15. SHAREHOLDERS' EQUITY

	2005	2004
Common shares – 29,509,876 outstanding (2004 – 30,111,976)	**$ 490**	$ 500
Contributed surplus	**4**	—
Deficit	**(48)**	(19)
	$ 446	$ 481

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. Under the Arrangement, the Company issued 30,111,976 common shares in 2004. There were no other classes of shares outstanding at December 31, 2005 and 2004. The weighted average number of common shares outstanding used for calculating loss per share was 29,728,060 for 2005 (2004 – 30,111,976).

During 2005, the Company repurchased a total of 602,100 shares at a weighted-average price of CAD$12.79 per share for total consideration of $6. As the purchase price was below the stated value of the common shares, the transactions resulted in a decrease of common stock of $10 and contributed surplus of $4.

During 2005, the Board of Directors granted certain officers of the Company options to purchase 30,000 shares of the Company at CAD$14.59 per share. Total options outstanding at December 31, 2005 were 245,000, with a weighted average exercise price of CAD$16.22 (2004 – 215,000 at CAD$16.45). These options have a ten year life and vest evenly over five years. Total compensation expense in each of 2004 and 2005 related to these options was less than $1. Outstanding options had no dilutive effect on loss per share.

NOTE 16. CHANGE IN NON-CASH WORKING CAPITAL

The net change in non-cash working capital balances comprises the following:

	2005	2004
Cash provided by (used for):		
Accounts receivable	**$ 7**	$ (55)
Inventory	**(15)**	(13)
Accounts payable and accrued liabilities	**(12)**	(15)
	$ (20)	$ (83)

NOTE 17. COMMITMENTS AND CONTINGENCIES

Countervailing Duty and Anti-dumping Duty

The U.S. International Trade Commission ("ITC") has imposed countervailing duties ("CVD") and anti-dumping duties ("ADD") on Canadian lumber exported to the U.S. Fraser Papers' New Brunswick mills are subject to ADD. In 2005 the total paid for these duties is $3 (2004 – $6). As at December 31, 2005, Fraser Papers has paid total duties of $15 since the introduction of the duties.

Fraser Papers and other Canadian forest product companies, the Canadian Federal Government and Canadian provincial governments categorically deny the U.S. allegations. Decisions by various trade bodies have lowered the CVD rates and ADD rates from those initially established. Notwithstanding the rates established in the investigations, the final liability for the assessment of CVD and ADD will not be determined until the appeal process is complete or a negotiated settlement is reached.

Foreign Exchange Hedges

As at December 31, 2005, the Company has entered into forward foreign exchange contracts of CAD$70 (2004 – CAD$109), which are designated as a hedge against certain Canadian dollar-denominated monetary liabilities. The consolidated statements of operations include a realized gain of $2 (2004 – $5) on matured monetary liability hedges and an unrealized loss of less than $1 (2004 – gain of $2) on outstanding hedges. These realized and unrealized gains or losses are offset by realized and unrealized losses on the monetary liabilities being hedged.

Commodity Hedges

Fraser Papers has entered into a pulp swap to deliver 24,000 tonnes of market pulp through December 2006 at an average price of $574 per tonne. This swap effectively fixes the selling price on a portion of Fraser Papers' production and is designated as a hedge of a portion of future pulp sales. The unrealized loss on this hedge was $2 at December 31, 2005 (2004 – $9).

During the year, Fraser Papers entered into lumber futures contracts for 31 million board feet of lumber (MMfbm) (2004 – 72 MMfbm). These contracts effectively fix the selling price for lumber delivered on the expiry date and were designated as a hedge of a portion of future lumber sales. During the year, Fraser Papers realized no gains (2004 – $1) on these contracts. There were contracts for 13 million board feet outstanding on December 31, 2005 (2004 – nil). The unrealized losses on these contracts were less than $1.

Guarantees

Norbord provided guarantees for certain obligations of Fraser Papers under a financial commitment agreement (the "FCA"). These guarantees were previously obligations of the Division. At December 31, 2005, the maximum potential amount of the obligations guaranteed was estimated to be $13.

Under the initial terms of the FCA, Fraser Papers agreed to provide letters of credit or other acceptable collateral to secure any guarantees outstanding on December 27, 2005. During 2005, the FCA was amended such that Fraser Papers will be required to provide letters of credit or other acceptable collateral to secure any guarantees outstanding on December 27, 2006. 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 Fraser Papers' manufacturing facilities.

Other

Fraser Papers has entered into various commitments for the future supply of operating services and materials. Commitments under operating leases and other obligations for which the cash flows are fixed or determinable at December 31, 2005, are:

2006	$ 36
2007	16
2008	16
2009	7
2010	6
Subsequent	7
	$ 88

NOTE 18. RELATED PARTY TRANSACTIONS

As a result of the Arrangement, Fraser Papers has a number of relationships with Brookfield and Norbord. Transactions with these related parties not described elsewhere in these notes included:

Fraser Papers purchases certain of its electricity from Brookfield. During 2005, Fraser Papers purchased $8 (2004 – $10) of electricity from Brookfield. Included in accounts payable and accrued liabilities is $1 (2004 – $1) owing to these related parties.

Fraser Papers purchases certain of its fibre requirements from Brookfield. During 2005, Fraser Papers purchased $10 (2004 – $5) of wood fibre and pulp from Brookfield. Included in accounts payable and accrued liabilities is $1 (2004 – $1) owing to these related parties.

During 2005, Fraser Papers exercised its option to acquire a 25-megawatt cogeneration plant in Berlin, New Hampshire for $34 from Brookfield. Prior to the acquisition, Fraser Papers purchased all of the output of this facility under a tolling agreement. By acquiring this facility, Fraser Papers removed Norbord from its guarantee of amounts owing under the tolling agreement.

Fraser Papers has invested in convertible, term, preferred units of Katahdin Paper Company LLC ("Katahdin"), a wholly owned subsidiary of Brookfield. Katahdin operates two paper mills in Maine. The units earn a preferential cumulative distribution of 5% per annum and are convertible into common equity units of Katahdin at a price based on a pre-determined formula. Cumulative distributions accrued on this investment amount to $1. The investment is accounted for using the cost method and is included in other assets.

Fraser Papers has leased certain productive equipment owned by Katahdin. The amount of the lease payments 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 a lease payment. During 2005 Fraser Papers earned a management fee of $7 from Katahdin (2004 – $5). Included in accounts receivable is $2 of accounts receivable from Katahdin. During 2005, Fraser Papers sold less than $1 of goods and services to Katahdin.

During the fourth quarter of 2005, the Company outsourced the management of its New Brunswick timberlands to Brookfield. Management fees charged during the year amounted to less than $1.

Fraser Papers paid less than $1 (2004 – less than $1) to Brookfield for rent.

Brookfield has provided the Company with a facility with a notional amount of $150 to enter into forward foreign exchange contracts as part of the Company's hedging activities. At December 31, 2005, the Company has entered into forward foreign exchange contracts of CAD$70 (2004 – CAD$109) under this facility.

Fraser Papers paid Norbord less than $1 for administrative services for the years ended December 31, 2005 and 2004.

During 2005, Fraser Papers sold $4 of pulp to Smart Papers, a company in which Fraser Papers owns a 40% equity interest, in the period subsequent to the sale of the Midwest Operations.

Fraser Papers leases a boiler to Smart Papers. The lease runs through 2014 and is considered a direct financing lease due primarily to the ability of Smart Papers to purchase the boiler at the end of the lease term for a nominal amount. Lease payments of $2 due in the next twelve months are included in accounts receivable. Lease payments due beyond one year of $14 are included in other assets. Unearned finance income of $1 will be recorded in earnings over the life of the lease. By acquiring this boiler, Fraser Papers removed Norbord from its guarantee of amounts owing under the lease.

All related party transactions are recorded at the exchange amount.

NOTE 19. SUBSEQUENT EVENT – SALE OF TIMBERLANDS ASSETS

On January 31, 2006, the Company sold its timberland assets in New Brunswick to Acadian Timber Income Fund ("Acadian" or the "Fund"). Acadian is a newly formed income fund which financed the acquisition through an initial public offering of equity securities and the issuance of bank debt. The Company was the promoter of the Fund.

Net proceeds were $125, including $94 in cash. The proceeds included $31 of securities which are convertible into 3,613,780 units of the Fund, representing a 22% interest in the Fund on a fully diluted basis. These securities are entitled to the same rights as units of the Fund and are entitled to cash distributions from the Fund. The Company will account for its investment using the equity method. The Company expects to record a gain on the sale in the first quarter of 2006.

Fraser Papers has entered into an agreement with Acadian whereby Fraser Papers will have the right to purchase fibre for 20 years at prevailing market prices. The amount of fibre available to Fraser Papers under the agreement will approximate its historical consumption from its New Brunswick timberlands.

Certain liabilities of the New Brunswick timberlands were retained by Fraser Papers consisting primarily of employment, pension and post-retirement obligations related to past service.

NOTE 20. SEGMENTED INFORMATION

Fraser Papers has two reportable segments:

(i) Paper, comprised of the paper, pulp and sawmill operations; and

(ii) Timber, comprised of the Maine and New Brunswick timberland operations.

In determining its reportable segments, Fraser Papers considers that it is an integrated producer of paper and pulp as its principal business. Management considers that its sawmill operations are an integral part of the paper operations. One of the key functions of the sawmills is to provide fibre in the production of pulp and paper and they therefore are considered part of the Paper segment. Management has determined that its timberlands operations have unique operational and financial characteristics and are managed differently.

Certain administration costs are allocated to the segments based on, among other things, the approximate amount of administrative resources expended on the segment.

As described elsewhere in these notes, Fraser Papers sold its timberlands in 2005 and 2006. Concurrent with those sales Fraser Papers entered into fibre supply agreements with the purchasers, whereby Fraser Papers has the right to purchase fibre from the purchasers for a period of 20 years at prevailing market rates. The amount of fibre available to Fraser Papers under both agreements is expected to approximate its historical usage from the sold lands.

Fraser Papers operates principally in Canada and the United States.

Operating Segments

	Paper	Timber	Inter-segment	Combined Total
2005				
Net sales	**$ 874**	**$ 74**	**$ (30)**	**$ 918**
Less: Cost of sales	**882**	**62**	**(30)**	**914**
Earnings before interest, income taxes, depreciation, restructuring charges and other	**(8)**	**12**	**—**	**4**
Depreciation	**(38)**	**(1)**	**—**	**(39)**
Restructuring charge	**(8)**	**—**	**—**	**(8)**
Operating loss	**$ (54)**	**$ 11**	**$ —**	**$ (43)**
Assets				
Segmented	**$ 657**	**$ 28**	**$ (3)**	**$ 682**
Non-segmented				**31**
Cash				**75**
Total assets				**$ 788**
Capital investments	**$ 49**	**$ —**		**$ 49**
2004				
Net sales	$ 952	$ 85	$ (41)	$ 996
Less: Cost of sales	943	74	(41)	976
Earnings before interest, income taxes, depreciation, restructuring charges and other	9	11	—	20
Depreciation	(47)	(1)	—	(48)
Restructuring charge	(7)	—	—	(7)
Operating loss	$ (45)	$ 10	$ —	$ (35)
Assets				
Segmented	$ 699	$ 64	$ (3)	$ 760
Non-segmented				10
Cash				—
Total assets				$ 770
Capital investments	$ 6	$ 1		$ 7

Geographic Segments

Net sales by geographic segment are determined based on the country of shipment.

	Net Sales		Property, Plant and Equipment	
	2005	2004	**2005**	2004
United States	**$ 678**	$ 778	**$ 203**	$ 274
Canada(1)	**240**	218	**156**	214
Combined total	**$ 918**	$ 996	**$ 359**	$ 488
(1) Export Sales included in total	**$ 147**	$ 117		

NOTE 21. SUBSEQUENT EVENT

On March 7, 2006, the Company announced the permanent closure of its pulp mill in Berlin, New Hampshire. The closure of the mill will result in severance and other costs of $3. As at December 31, 2005, property, plant and equipment includes $40 and other assets include $8 related to this operation. The Company is currently evaluating alternatives for these assets and expects to record a material, non-cash impairment charge related to these assets in the first quarter of 2006.

NOTE 22. COMPARATIVE FIGURES

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

Directors and Officers of the Company

DIRECTORS

Rorke B. Bryan (3)
Corporate Director

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

Dian Cohen, C.M. (1) (2) (5)
President
DC Productions Limited

J. Bruce Flatt (4)
President and Chief Executive Officer
Brookfield Asset Management Inc.

Paul Gagné (1) (4) (5)
Corporate Director

Dominic Gammiero
President and Chief Executive Officer
Fraser Papers Inc.

Robert J. Harding, FCA (2) (5)
Chairman
Brookfield Asset Management Inc.

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

Margot Northey (1) (3) (4)
Corporate Director

Sam Pollock (3) (5)
Managing Partner
Brookfield Asset Management Inc.

OFFICERS

Dominic Gammiero
President and Chief Executive Officer

Peter Gordon
Senior Vice President, Finance and
Chief Financial Officer

Glen McMillan
Senior Vice President and
Chief Administrative Officer

Pierre McNeil
Senior Vice President, Human Resources and Wood Products

William Manzer
Senior Vice President,
Pulp and Paper Operations

Marina Mueller
Assistant Corporate Secretary

Committees of the Board:
(1) Audit
(2) Corporate Governance and Nominating
(3) Environment, Health and Safety
(4) Human Resources
(5) Pension
For a full description of the Board committees, and corporate governance practices, please see Fraser Papers' Management Proxy Circular on our web site at www.fraserpapers.com

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Pulp sales

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SHAREHOLDER INFORMATION

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Note: This report contains "forward-looking statements" that are based on certain assumptions and reflect the Company's current expectations. The words "believe," "expect," "anticipate," "intend," "estimate" and other expressions which are predictions of or indicate future events and trends and which do not relate to historical matters identify forward-looking statements. Reliance should not be placed on forward-looking statements because they involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of the Company to differ materially from anticipated future results, performance or achievement expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially from those set forth in the forward-looking statements include general economic conditions, interest rates, availability of equity and debt financing and other risks detailed from time to time in the documents filed by the Company with the securities regulators in Canada. The company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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