

FraserPapers

ANNUAL REPORT 2007

Corporate Profile

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

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

Financial Highlights

<i>(US\$millions, except per share data)</i>	2007	2006	2005
Net sales ⁽¹⁾	\$ 714.7	\$ 795.9	\$ 918.0
EBITDA	(44.1)	(7.2)	4.3
Loss	(43.7)	(113.8)	(28.4)
Total assets	543.1	554.2	788.6
Net debt	85.9	53.9	76.4
Number of common shares outstanding ⁽²⁾	29.5	29.5	29.5
Loss per share, basic and diluted	\$ (1.48)	\$ (3.86)	\$ (0.98)
Total paper produced (000 tons)	608	661	723

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

(2) Millions of shares.

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Letter to Shareholders

OVERVIEW

Our results from the past year were disappointing for the employees at Fraser and clearly for our shareholders. Like others in our industry, we experienced a number of unprecedented market and input cost pressures that more than offset our ability to respond with improvements to our core business. One market issue stood out in particular: the strength of the Canadian dollar. With virtually all of our sales transacted in U.S. dollars but half of our assets located in Canada, the currency impact alone during the year was \$20 million. Added to this were costs for a number of our commodity inputs, including pulp, oil and process chemicals, that continued to rise during the year erasing an additional \$29 million from our bottom line. In all, it was a very difficult environment and it required us to substantially change our short-term operating plans.

We took action at every operation that resulted in aggregate savings of \$23 million during the year – a meaningful accomplishment but insufficient to counter the \$50 million of cost pressures described above. At our core East Papers operations, we completed a rebuild of the recovery boiler at the Edmundston pulp mill to expand its productive capacity; shut two of our smallest and highest cost paper machines; and, closed one oil-fired boiler and turbine. As the boiler rebuild at Edmundston required costly downtime and the machine closures became effective only in the fourth quarter, the aggregate improvement at East Papers of \$6 million during 2007 was much less than it will be in the future. The full impact will be seen over 2008 and should exceed our original expectation of \$17 million in annual cost reduction. At the non-integrated Gorham paper mill, we also took out capacity and operated only four of five paper machines during the second half of 2007. In addition, the mill operating team focused on optimizing the mix of purchased pulp, reducing process losses and lowering energy consumption at the mill. These efforts improved our situation by some \$13 million. At our Thurso pulp mill, improved efficiency and higher production combined with cost reduction initiatives surrounding wood procurement, chemical and oil consumption, generated \$4 million in savings. Finally, interim closures were announced at the lumber operations as soon as alternative sources of softwood chips had been secured for our

Edmundston pulp mill. At year-end, we had reduced our lumber production to approximately 50% of capacity.

We repaid long-term debt through the sale of our interest in the Acadian Timber Income Fund for proceeds of \$38 million and at year-end launched a \$60 million rights offering to shareholders. With lower debt and a substantial injection of equity, our balance sheet remains conservative compared with our peers in the industry.

Pulp and paper prices improved modestly over the course of the year as consolidation and rationalization in the broader segments of the industry brought market fundamentals into better balance. Average prices across all grades of our paper increased \$29 per ton and generated incremental revenue of \$17 million during the year. We grew volumes and secured additional market share in a number of strategic segments, including sales of our packaging grades, which increased 7%, and volumes of highbright groundwood paper, which were 31% higher over the comparable twelve months in 2006. We benefited from tighter pulp markets on sales of hardwood pulp surplus to our internal requirements with prices \$50 per tonne higher than last year bringing in an additional \$6 million in revenue. Unfortunately, we lost ground in the lumber markets as prices fell hard, hit twenty-year lows and impacted us by \$10 million, on a year-over-year basis.

There is much work left to do in 2008 but importantly, many opportunities yet to capture. Recognizing that we have to accelerate change, we continue to recruit new people to the organization, adding necessary skills and experience to the management team in areas of strategic importance. We are working on a number of new product development initiatives that are of importance to our customers. On the operating side of the business, we will continue to focus on energy conservation, efficiency and productivity through operating initiatives and high return, immediate payback capital projects. From a market perspective, we are benefiting from positive price momentum in the paper markets and during the first quarter 2008, we implemented increases which, when combined with some favourable product mix developments, have improved our mill nets in excess of

\$40 per ton. The hardwood pulp markets also remain firm with prices modestly higher in the first quarter over the end of last year.

STRATEGY

Our focus on **value-added products** remains valid today as we continue to seek opportunities to achieve premium pricing over commodity paper grades in relatively small but discreet segments of the broader market. Most of these specialty segments continue to be stable or growing, despite the declining trends in certain commodity paper markets. Our competitive advantage is based on manufacturing a wide range of lightweight coated and uncoated papers to meet narrow technical specifications.

We believe that our manufacturing competencies, when combined with responsive **customer service**, provide a compelling reason for people to do business with us and we consistently receive positive feedback from our customers that recognizes individual efforts of Fraser employees who have exceeded their expectations. Our team also provides technical service in our customers' press rooms and converting operations where we seek to lower the overall cost of the application in which our paper is being used. Despite difficult financial results, we are investing in the future through a team of product development engineers who are creating **innovative new products** to support the long-term growth of our business.

Finally, we know it is important to compare our **operating performance against the best in the industry** and recognize that today, there is still a shortfall in certain areas. We are confident that we can close these remaining gaps significantly during 2008 as we have achieved most of the objectives for short periods of time, but just not on a consistent basis. To support this initiative, we introduced new management systems that are improving **execution** of daily plans **and overall performance** throughout the organization.

OPERATING PLATFORM

Our integrated operating platform of lumber mills, pulp mills and paper mills, located in both Canada and the United States, was originally configured during an environment with a favourable exchange rate combined with low energy and fibre costs. Many of the advantages still exist, including security of fibre supply and our capability to develop, manufacture and take to market a broad variety of specialty papers from three different sources of internal pulp fibre. However, at the present time

these advantages are being offset by the negative impact of the strong Canadian dollar. In response, we are working closely with the Government of New Brunswick on a number of initiatives to improve the long-term competitiveness of our asset base located in the province.

We have three pulp mills that are integrated into our paper business, providing high quality fibre produced to our specifications at a lower cost than purchased pulp. The ability to produce hardwood kraft, softwood sulphite and groundwood pulp within our own system provides the flexibility to develop and manufacture a wide variety of groundwood, freesheet and hybrid papers in response to market opportunities. For example, we have been able to benefit from the expanding market for high-bright groundwood paper that is replacing traditional freesheet in specialty print applications.

During the year, we reduced the number of paper machines from 13 to 11 at two locations. Given that we have the capability of producing similar grades of paper across different machines, we were able to optimize customer orders across the platform and retain the highest margin business despite reducing overall capacity from 675,000 to 635,000 tons. We continue to align size of our individual market segments and product specifications with our machine size and capability and retain market share.

As a recovery in the lumber markets appears to be at least 12 to 18 months away, we took as much downtime at our lumber mills as we could without jeopardizing wood chip supply to the Edmundston pulp mill. At current lumber prices, the net price of wood chips, the by-product of the lumber mills, has risen dramatically. With a prolonged downturn in this lumber market, we are critically reviewing our strategy. Our four mills in New Brunswick and Maine, like most others in eastern North America, are small relative to the industry and lack the size and scale to compete effectively.

INDUSTRY DYNAMICS

The North American paper industry is changing dramatically in this environment of rising input costs and foreign exchange. There has been a significant rationalization and consolidation in the newsprint, coated and uncoated paper markets leaving each market with larger, better capitalized players. The dramatic weakness in the U.S. dollar has also resulted in meaningful decline in imports of paper from Europe and Asia to the U.S. and

has resulted in capacity closures in Canada. The direct and positive consequence of these two trends is that paper markets have been put in better balance relatively quickly. As well, we are finding that as the largest players focus on their strengths and pursue the broader commodity segments, the smaller value-added segments that require a higher degree of customization and service have been left to niche producers, including Fraser.

SUMMARY AND OUTLOOK

We remain determined to rebuild our Company into a profitable and sustainable business where shareholders can expect to receive an acceptable return on their capital invested with us. Unfortunately, given this environment of unprecedented volatility in input costs and exchange rates, it is taking more time than we would like. Experience has taught us that cyclical markets will eventually turn and those well capitalized companies that can withstand the pressures of a secular downturn will prosper over the long term.

The opportunities we see in our packaging segment remain encouraging. These markets are growing and specific products are consistent with our strengths in coated and lightweight papers. We believe that we are able to provide a compelling value proposition that includes high quality paper that runs consistently well in our customers' operations, backed by a very high level of customer service and technical support. In the short term, our largest opportunity lies in improving the performance of our existing asset base. With a high fixed cost structure, pulp and paper mills offer significant leverage if they can operate at high levels of throughput on a consistent basis.

Our focus on reliability and process efficiency is designed to do that. Our cost reduction initiatives will remain focused on energy and fibre, two key business drivers of our success.

We do believe that opportunities will emerge to grow our business as the industry consolidates and certain producers exit segments through capacity rationalization, exchange pressures and process optimization. We continue to evaluate assets and businesses as they become available to determine if there is value to be created within our Company.

On behalf of all of the employees at Fraser, we would like to acknowledge your patience and support through this difficult period of time. We are committed to achieving the targets we have set, with the goal of emerging from this current industry environment a profitable company, creating sustainable value for our shareholders.



J. Peter Gordon
President and Chief Executive Officer

March 10, 2008

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") presents the factors that had a material effect on our results of operations during the years ended December 31, 2007 and 2006. 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, 2007 and 2006 and for the years then ended, and the notes thereto. Our consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). This MD&A contains forward-looking statements. See "Forward-Looking Information".

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

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

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

INTRODUCTION

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

Our fourth quarter 2007 MD&A dated February 5, 2008 relating to our unaudited interim consolidated financial results and notes thereto for the three month period ended December 31, 2007 is specifically incorporated by reference herein, except to the extent any statement made therein is modified or superseded by this document.

BUSINESS PROFILE

Fraser Papers is an integrated specialty paper company which produces a broad range of specialty packaging and printing papers. We also produce northern bleached hardwood kraft pulp and dimension lumber. The Company employs approximately 2,600 people and has operations in New Brunswick, Maine, New Hampshire and Quebec. The geographical breakdown of property, plant and equipment at the end of 2007 was 49% U.S. and 51% Canada.

Principal manufacturing facilities included:

- 11 paper machines at two paper mills in Madawaska, Maine and Gorham, New Hampshire;
- one market pulp mill, producing northern hardwood kraft pulp in Thurso, Quebec;
- one integrated pulp operation in Edmundston, New Brunswick, producing softwood sulphite pulp and groundwood pulp; and
- four sawmills in Plaster Rock and Juniper, New Brunswick and Masardis and Ashland, Maine.

The annual production capacity of these facilities at December 31, 2007 was:

- 635,000 tons of paper, including towel;
- 460 million board feet of lumber;
- 250,000 tonnes of market pulp;
- 270,000 tonnes of internally used sulphite pulp; and
- 120,000 tonnes of internally used groundwood pulp.

In conjunction with the sale of the timberlands in 2005 and 2006, Fraser Papers has entered into agreements whereby it will have the right to purchase fibre for a period of up to 20 years at prevailing market prices. The amount of fibre available to Fraser Papers under these agreements will approximate its historical consumption from the timberlands. Fraser Papers also purchases timber, chips and other wood residues on the open market.

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

STRATEGY

Our objective is to provide our shareholders with a 12% return on equity over the long term. While recent results have clearly not met this objective, we remain committed to the following business strategy:

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

In addition to these key strategic initiatives, Fraser Papers will continue to look for opportunities to grow its specialty paper franchise opportunistically, based on value. The Company has significantly narrowed its operational focus in recent years such that future growth can be specifically targeted to Fraser Papers' core business.

In 2007, Fraser Papers completed a number of strategic initiatives that were designed to advance our business consistent with our strategy.

Value-added Products

Fraser Papers competes in specific market segments where we can utilize our capability in the manufacture of lightweight freesheet and high-bright groundwood papers for a number of specialty applications. We focus on select printing and consumer packaging applications. Typically, these discrete market segments are small relative to the broader North American commodity markets and are a good match for our paper machine capabilities and capacities. The particular markets that we are focused on are generally between 50,000 to 1,000,000 tons in size and provide Fraser Papers with the opportunity to have an influential market share. Approximately 80% of our annual production is in these markets today. Over time, we seek to grow the volume of business we have in these core paper markets where we feel we can achieve the best margins. These market segments involve food and other consumer packaging paper grades, financial printing and other lightweight freesheet papers, and specialty high-bright groundwood papers.

In 2007, we closed two small, freesheet paper machines at our Madawaska, Maine paper mill. The two machines represented approximately 70,000 tons per year of paper production or 15% of the paper mill's capacity. The closures allowed us to lower our exposure to certain commodity papers and produce a higher quality mix of value-added products. As a result, our shipments of specialty packaging papers increased by 7% while high-bright groundwood shipments increased by 31% compared to 2006. Our proportion of commodity products as shipments of commodity grades fell 16%.

Superior Customer Service

Superior customer service is the cornerstone of Fraser Papers' value proposition to its customers. We strive to meet our customers' high technical standards and challenging logistical demands as well as providing superior technical support services to our converting and printing customers.

Fraser Papers is able to provide its customers with Forest Stewardship Council ("FSC") certified book papers such as the paper used in the first and second printing of the U.S. edition of *Harry Potter and the Deathly Hallows* by J.K. Rowling. Additionally, the Company has begun shipping anti-microbial office paper to meet customers' needs. All Fraser Papers' pulp and paper facilities can provide certified products under either the FSC or Sustainable Forestry Initiative ("SFI") certification.

Innovation

Product development continues to be an important component of the Company's marketing initiatives. During 2007, the Company developed 36 new specialty products for applications in the packaging, financial printing, converting and consumer goods market segments. We have again achieved our goal of continually developing new products as approximately 12% of volume sold in 2007 represents products that were developed in the past 24 months.

During 2007, the Company announced the launch of Custom Snowcote®, a lightweight, filmcoated specialty print product. Custom Snowcote is targeting high opacity applications, including reference books and text books and represents one example of Fraser Papers' many product development initiatives with new and existing customers.

Improved Operating Performance

We have undertaken a number of initiatives that will lower our operating costs. In response to the rapid escalation of oil costs, two projects focused on energy were announced.

- An oil-fired boiler and turbine in the Edmundston, New Brunswick pulp mill, which was traditionally used in the winter, was shut in 2007. The closure will reduce oil consumption by 3.5 million gallons per year, resulting in \$4 million in energy savings and a 35% reduction in greenhouse gas emissions. In the fourth quarter, oil consumption was lower by 1.2 million gallons compared to the fourth quarter of 2006 representing a savings of \$1.9 million.
- A heat recovery system will be installed at the Thurso, Quebec pulp mill. The heat exchanger will reduce the mill's fossil fuel use by approximately 5% to 10% and reduce greenhouse gas emissions. The estimated savings on an annual basis will be \$1.4 million. This equipment will be commissioned in the first quarter of 2008.

In 2007, Fraser Papers completed a 21 day major maintenance outage at its Edmundston, New Brunswick sulphite pulp mill. The outage included \$9.2 million in capital spending to rebuild the recovery boiler at the integrated pulp mill. This outage supports our objective of reducing fibre costs by maximizing internal pulp production. This will enable the Madawaska paper mill to displace purchased pulp fibre with expected annual savings in excess of \$3 million. During the second half of the year, the internal pulp production at Edmundston improved to design levels, producing up to 740 tons per day on a sustained basis. However, a number of operational difficulties and difficulties obtaining raw materials contributed to intermittent downtime, resulting in average daily production which was comparable to the first half of the year.

RECENT DEVELOPMENTS

East Papers Optimization

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

The Company estimates annual savings from this initiative to be \$10 million per year, primarily as a result of exiting certain market segments with negative margins, reducing overall fixed costs and reducing purchases of oil and other higher cost inputs.

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

Sale of New Brunswick Timberlands and Acadian Timber Income Fund

During 2007, the Company sold its remaining interest in Acadian Timber Income Fund ("Acadian" or the "Fund") for proceeds of \$38.4 million. As the book value in the units of Acadian was nil, a gain of \$38.4 million was recorded.

The interest in Acadian was received in January of 2006 when the Company sold its timberlands in New Brunswick (the "NB Timberlands") to Acadian, a newly formed income fund which financed the acquisition through an initial public offering of equity securities and bank debt.

The Company received net proceeds of \$125.0 million including cash of \$93.5 million and securities with a value of \$31.5 million. The securities were exchangeable for 3.6 million units of the Fund, representing a 22% interest in the Fund on a fully-diluted basis. The Company realized a pre-tax gain of \$71.0 million on the sale of the NB Timberlands in 2006.

In conjunction with the sale of assets to the Fund, we entered into a 20 year fibre supply agreement with Acadian which will provide us with substantially the same volumes of fibre that we had historically received from our freehold timberlands at prevailing market prices.

Repayment of Senior Notes

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

In 2006, the Company repaid \$66.0 million in principal amount of the Notes, including \$14.5 million of Notes held by Fraser Papers. A write-down of deferred financing costs of \$1.5 million, related to the repayments under the tender offer was reflected in the Consolidated Statements of Operations and Statements of Cash Flows.

Rights Offering

During 2007, Fraser Papers announced a rights offering (the "Offering") under which the Company granted its existing shareholders the right to purchase 20,656,913 shares at a purchase price of CAD\$2.90 per share. In connection with the Offering, Brookfield entered into a Standby Purchase Agreement in which Brookfield agreed to exercise all of its rights and to purchase the common shares not otherwise subscribed for by other shareholders. Subsequent to year-end, the Company issued 20,656,913 common shares and received CAD\$59.9 million in proceeds under the Offering. Brookfield purchased 18,813,241 additional common shares for total proceeds of CAD\$54.6 million, increasing its ownership interest in the Company to approximately 70.5%. Proceeds were used to pay outstanding indebtedness including the temporary \$50.0 million financing.

Closure of Berlin Pulp Mill

During 2006, Fraser Papers permanently closed its pulp mill in Berlin, New Hampshire and recorded a charge of \$50.3 million of which \$45.2 million is related to an impairment in property, plant and equipment and other assets and the balance was for various costs related to closure. The decision to shut down the pulp mill enabled a consolidation of Fraser Papers' market pulp sales position at its remaining hardwood pulp mill in Thurso, Quebec and eliminated lower margin export sales, providing for an overall improvement in the average realization on sales.

Losses from Smart Papers

In 2006, Smart Papers LLC and its affiliates ("Smart Papers"), a previous equity investment of the Company, filed for creditor protection under Chapter 11 of the United States Bankruptcy Code. As a result, Fraser Papers recorded a charge of \$111.4 million, consisting of an impairment charge against its investment in Smart Papers of \$74.0 million, a provision of \$37.4 million against a receivable from Smart Papers and estimated accruals.

KEY FACTORS AFFECTING OUR BUSINESS

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

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

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

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

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

Fraser Papers' margin improvement plan concentrates on the usage of raw materials and discretionary spending. In 2007, we created \$22.9 million of margin improvements compared to 2006 costs by focusing on fibre substitution and energy optimization. In addition, we significantly reduced oil consumption which will reduce our dependence on high cost oil.

Foreign Currency Risk: As approximately 50% of our book value in plant, property and equipment is located in Canada and virtually 100% of our sales are denominated in U.S. dollars, we are exposed to fluctuations in foreign exchange rates. Changes in these exchange rates could have a material effect on our results of operations. To mitigate these effects, we hedge both cash flow and balance sheet exposures when appropriate.

RESULTS OF OPERATIONS AND RELATED INFORMATION

Overview

Fraser Papers is executing a comprehensive turnaround of its financial and operating affairs. The Company implemented a number of paper optimization initiatives and energy reduction initiatives and took downtime at its sawmills in an effort to reduce costs. Despite these initiatives to improve the Company's performance, higher fibre and energy costs, weak lumber markets and the stronger Canadian dollar led to negative EBITDA in the year. Continued weak housing markets have depressed demand for lumber and other building products. Our lumber operations, which are integrated with our core pulp and paper operations in order to provide a secure supply of wood chips and biomass fuel, operated at 52% of capacity in 2007 and generated negative results.

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

	For Year Ended December 31	
	2007	2006
Paper operations		
EBITDA ⁽¹⁾ (US\$millions)	(21.9)	1.8
Less: Impact of outages	(13.6)	(8.8)
Adjusted EBITDA ⁽²⁾	(8.3)	10.6
Adjusted EBITDA Margin (\$ per ton)	(14)	16
Adjusted Average Cash Cost ⁽¹⁾ (\$ per ton)	933	867
Pulp operations		
EBITDA ⁽¹⁾ (US\$millions)	(0.2)	(13.4)
Less: Impact of Berlin pulp mill	—	(4.3)
Less: Impact of pulp hedges	—	(3.5)
Less: Impact of outages	(5.0)	(7.2)
Adjusted EBITDA ⁽²⁾	4.8	1.6
Adjusted EBITDA Margin (\$ per tonne)	21	6
Adjusted Average Cash Cost ⁽¹⁾ (\$ per tonne)	530	488
Lumber operations		
EBITDA ⁽¹⁾ (US\$millions)	(22.0)	2.0
Less: Impact of duties refund	—	14.4
Adjusted EBITDA ⁽²⁾	(22.0)	(12.4)
Adjusted EBITDA Margin (\$ per Mfbm)	(68)	(33)
Adjusted Average Cash Cost ⁽¹⁾ (\$ per Mfbm)	342	336

(1) See "Definitions" section.

(2) Adjusted EBITDA has been adjusted for outages, the Berlin pulp mill, pulp hedges and duties refund.

Fraser Papers generated an EBITDA loss of \$44.1 million in 2007. The paper operations generated an EBITDA loss of \$21.9 million, the pulp operations generated an EBITDA loss of \$0.2 million and the lumber operations generated an EBITDA loss of \$22.0 million.

Paper operations in 2007 generated an EBITDA loss of \$21.9 million which included \$13.6 million of costs associated with a major maintenance outage at the Edmundston sulphite pulp mill and related paper machine downtime and a maintenance outage at the cogeneration facility in Edmundston, New Brunswick. The adjusted EBITDA loss in 2007 for paper operations excluding the impact of the outages was \$8.3 million. Paper operations in 2006 generated positive EBITDA of \$1.8 million which included \$8.8 million of costs associated with a major unplanned maintenance outage at the Edmundston pulp mill and an annual maintenance outage at the Company's cogeneration facility in Edmundston, New Brunswick. The adjusted EBITDA for paper operations in 2006 excluding the impact of the outages was \$10.6 million.

Paper pricing for specialty packaging, specialty printing and commodity freesheet grades increased 3.9% over 2006 but was more than offset by increased cash costs in the paper business. The Canadian dollar increased from US\$0.88 to US\$0.93 in 2007. The impact of the stronger Canadian dollar and higher fibre and oil costs for paper operations accounted for \$41.5 million of higher costs during the year, which were partially offset by improved productivity, energy usage and other cost improvements.

Pulp operations in 2007 generated negative EBITDA of \$0.2 million which includes \$5.0 million for the cost of the planned annual maintenance outage. The adjusted EBITDA in 2007 for pulp operations excluding the impact of the outage was \$4.8 million. Pulp operations in 2006 generated negative EBITDA of \$13.4 million which includes \$7.2 million for the cost of the planned annual maintenance outage, \$4.3 million associated with losses from the Berlin pulp mill and \$3.5 million in pulp hedge

losses. The adjusted EBITDA in 2006 for pulp operations excluding the impact of the outage, Berlin losses and pulp hedge losses was \$1.6 million.

Pulp markets improved during 2007 with average realized revenue increasing 10% or \$50 per tonne. The Canadian dollar increased from US\$0.88 to US\$0.93 in 2007.

Lumber operations in 2007 generated negative EBITDA of \$22.0 million. Lumber operations in 2006 generated EBITDA of \$2.0 million which included \$14.4 million of anti-dumping duties refunds. Adjusting for the refunds, the adjusted negative EBITDA in 2006 was \$12.4 million. Lumber operations' EBITDA declined by \$9.6 million compared to the adjusted 2006 EBITDA as a result of a 10% decrease in benchmark pricing and significant market-related downtime. The lumber market has deteriorated since the first quarter of 2006 with benchmark pricing down 23% or \$93 per Mfbm due to weak demand.

Summary of Quarterly Results

<i>(US\$ millions, except per share amounts)</i>	Net Sales	Earnings/(Loss)	Earnings/(Loss) per share <i>(basic and diluted)</i>
2007			
4th Quarter	\$ 186.3	\$ (20.8)	\$ (0.70)
3rd Quarter	172.3	24.8	0.84
2nd Quarter	181.7	(37.6)	(1.28)
1st Quarter	174.4	(10.1)	(0.34)
2006			
4th Quarter	\$ 187.2	\$ (11.0)	\$ (0.40)
3rd Quarter	185.1	(6.1)	(0.21)
2nd Quarter	207.7	(18.3)	(0.61)
1st Quarter	215.9	(78.4)	(2.64)

Operating Results

Net sales by segment for 2007 and 2006 were as follows:

<i>(US\$ millions)</i>	For Year Ended December 31	
	2007	2006
Paper	\$ 714.7	\$ 791.6
Timber ⁽¹⁾	n/a	6.7
Inter-segment	—	(2.4)
Total	\$ 714.7	\$ 795.9

(1) The Timber segment was sold in January 2006.

Net sales for 2007 were \$714.7 million, as compared to \$795.9 million in 2006. The decrease was due to lower sales volumes of paper as a result of the two paper machine permanent closures and the decline in the lumber market as well as the sale of the Timber segment assets in 2006.

Losses in 2007 were \$43.7 million compared to losses of \$113.8 million in 2006. The 2007 loss included a pre-tax restructuring charge of \$15.9 million associated with the machine closures and a pre-tax \$38.4 million gain on the sale of the Company's interest in Acadian and a one-time \$13.8 million tax recovery. The 2006 loss included a pre-tax loss of \$111.4 million for its investment in Smart Papers, a pre-tax \$50.3 million charge for the closure of the Berlin pulp mill and a pre-tax \$71.0 million gain for the sale of the NB Timberlands.

EBITDA by segment was as follows:

<i>(US\$ millions)</i>	For Year Ended December 31	
	2007	2006
Paper	\$ (44.1)	\$ (9.6)
Timber ⁽¹⁾	n/a	2.4
Total	\$ (44.1)	\$ (7.2)

(1) The Timber segment was sold in January 2006.

The Paper segment generated an EBITDA loss of \$44.1 million, a decrease of \$34.5 million from the 2006 EBITDA loss of \$9.6 million. The 2006 EBITDA loss included \$14.4 million of refunds of anti-dumping duties refunds. After adjusting for the anti-dumping duties in 2006, results deteriorated \$20.1 million. Significant input cost increases and the impact of a stronger

Canadian dollar were only partly offset by increased selling prices for pulp and paper and cost improvements. (See discussion in "Margin Improvements" and "Business Segments")

Depreciation expense was \$29.5 million in 2007 as compared to \$31.4 million in 2006. The reduced depreciation expense was the result of the closure of the two paper machines.

Margin Improvements

Through focusing on things we can control, Fraser Papers' operating performance improved through higher pulp production, lower oil consumption and improved sawmill productivity.

Fraser Papers' improvement initiatives focus on the year-over-year improvements in operating earnings assuming constant selling prices, exchange rates and commodity prices. The improvement program generated \$22.9 million in 2007 when compared to 2006. The cost reduction improvements were derived primarily from improved fibre utilization, labour and benefit costs due to restructuring and chemical and oil usage efficiencies.

<i>(Pre-tax US\$millions)</i>	2007 Margin Improvements
Sales and Production Volume	\$ (5.1)
Fibre Utilization	14.1
Labour and Benefits	8.0
Other Cost Reductions	5.9
Total	\$ 22.9

Margins and production volumes declined due to paper machine downtime associated with the 21 day Edmundston sulphite pulp mill maintenance outage and increased sawmill market-related downtime in 2007. Fibre utilization margin improvements were achieved primarily at East Papers by increasing the proportion of internally produced pulp compared to open market purchased pulp. Labour and benefit reductions were achieved from the East Papers optimization closure of two paper machines, sawmill market-related downtime and improved pension expense. Other cost reductions are primarily from improved oil and chemical usages as a result of the East Papers optimization and the closure of an oil-fired boiler. These initiatives served to only partially offset significant cost pressures from fibre, energy, chemical costs and foreign exchange which totaled \$48.7 million in 2007.

<i>(Pre-tax US\$millions)</i>	2007 Uncontrollable Pressures
Increased fibre pricing	\$ (13.0)
Increased energy pricing	(12.5)
Increased chemical pricing	(3.1)
Canadian/U.S. Foreign Exchange	(20.1)
Total	\$ (48.7)

Business Segments

Paper Segment

The Paper segment is comprised of 11 paper machines at two locations, one market pulp facility, two internal pulp facilities and four sawmills.

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

The following is a summary of financial information for the Paper segment:

<i>(US\$millions)</i>	For Year Ended December 31	
	2007	2006
Net sales	\$ 714.7	\$ 791.6
EBITDA ⁽¹⁾	(44.1)	(9.6)
Depreciation	29.5	31.4
Capital investments	18.0	12.7

(1) See "Definitions" Section.

The Paper segment is broken into three operations: Paper, Pulp and Lumber.

Paper Operations

Paper operations are comprised of the following product groups: specialty packaging, specialty printing, commodity freesheet papers, specialty high-bright groundwood, commodity groundwood and towel.

	For Year Ended December 31 2007	2006
Sales (US\$millions)	552.8	595.9
EBITDA (US\$millions)	(21.9)	1.8
Less: Impact of outages	(13.6)	(8.8)
Adjusted EBITDA	(8.3)	10.6
EBITDA (\$ per ton)	(37)	3
EBITDA margin ⁽¹⁾	(4%)	0%
Shipments (000 tons)		
Specialty packaging	72	67
Specialty printing	234	304
Commodity freesheet papers	68	72
Specialty high-bright groundwood	97	74
Commodity groundwood	78	102
Towel	39	39
	588	658
Average Revenue Realized (\$ per ton)		
Specialty packaging	1,148	1,138
Specialty printing	987	947
Commodity freesheet papers	853	804
Specialty high-bright groundwood	859	820
Commodity groundwood	717	736
Towel	800	774
Weighted Average (\$ per ton)	922	893
Average Cash Operating Cost (\$ per ton)	956	880
Reference Prices (\$ per ton) ⁽²⁾		
50# offset rolls	832	815
22.1# white directory	740	722

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

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

In 2007, market conditions continue to improve for specialty packaging, specialty printing and specialty groundwood grades. Average benchmark pricing for commodity uncoated freesheet (50# offset rolls) increased by 2% or \$17 per ton over 2006 to a level of \$832 per ton. Accordingly, Fraser Papers' average revenue realized per ton from commodity freesheet papers increased 6%. According to RISI, U.S. demand for uncoated freesheet in 2007 declined by 4.4%, principally due to electronic substitution and a weaker economy. This is in line with 3.9% reduction in capacity following industry wide paper mill closures. The weak U.S. dollar lowered imports of uncoated freesheet during the year.

Average benchmark pricing for commodity uncoated groundwood (22.1# directory) increased by 2% or \$18 per ton over 2006 to a level of \$740 per ton. According to the Pulp and Paper Products Council ("PPPC"), demand for uncoated mechanical pulp in 2007 increased 0.9% due to substitution from the strong coated groundwood market. Capacity increased by 3.5% with the restart of the Port Hawkesbury mill after a lengthy labor dispute. The weak U.S. dollar also lowered imports of uncoated mechanical pulp. These market conditions have enabled improved pricing in North America.

Fraser Papers' strategy is to target market segments where the Company can achieve a meaningful or leadership position and where we can match our technical competencies with the demand for lightweight freesheet papers. In 2007, Fraser Papers had approximately 80% of its freesheet paper sales that fit this description, and the strategy is to transition the balance into new or existing specialty market segments.

Specialty packaging products are typically used for food applications and utilize both stain resistant and non-stain resistant packaging papers. Fraser Papers has the ability to meet narrow technical standards for applications such as pet food bags and dry mix consumer pouches and bags. Packaging volumes increased by 5,000 tons or 7% compared to 2006 due to increased demand for stain resistant products. Specialty packaging pricing in 2007 improved by 1% compared to 2006.

Specialty printing papers include freesheet products that are characterized by narrow technical specifications and niche applications including labelling and thermal point-of-sale receipts as well as lightweight opaque grades for financial printing applications. Business volumes of Fraser Papers' specialty printing papers decreased by 70,000 tons compared to 2006 as a result of the migration of financial printing papers from freesheet to Fraser Papers' specialty high-bright groundwood and the permanent closure of two paper machines. Specialty printing pricing in 2007 improved by 4% compared to 2006.

For 2007, volume of commodity freesheet grades declined by 6% from 2006 as Fraser Papers continued to narrow its focus towards higher margin specialty packaging and printing paper products in strategic markets.

Specialty high-bright groundwood includes products that are used for financial printing and other applications where a high performance and superior print quality are required. Compared to 2006, Fraser Papers' shipments of specialty groundwood products increased 23,000 tons or 31% and average revenue realized increased \$39 per ton or 5%.

Compared with 2006, Fraser Papers' shipments of commodity groundwood products decreased 24% or 24,000 tons as we reduced our exposure to commodity papers.

In 2007, the paper business generated negative EBITDA of \$21.9 million compared to positive EBITDA of \$1.8 million in 2006. Excluding the impact of major outages, the paper operations had negative EBITDA of \$8.3 million in 2007 on sales of \$552.8 million compared to EBITDA of \$10.6 million in 2006 on sales of \$595.9 million. The \$18.9 million decrease in adjusted EBITDA was due to increased fibre and energy costs and the strength of the Canadian dollar of \$41.5 million, partly offset by higher mill net realizations and margin improvements.

Shipments decreased by 11% in 2007 compared to 2006 due to the permanent closure of two paper machines and the softening in retail, automobile and home building segments that directly impact pressure sensitive and point-of-sale applications. In addition, the recent price increases by the U.S. postal service have negatively impacted catalogue, magazine and commercial printing segments as publishers and printers work to change formats, basis weights and distribution strategies to mitigate the increasing costs of mailing.

Pulp Operations

The Company owns and operates a NBHK market pulp mill in Thurso, Quebec. In 2006, Fraser Papers closed its NBHK market pulp mill in Berlin, New Hampshire. The site has since been sold.

	For Year Ended December 31 2007	2006
Sales (US\$millions)	72.9	80.1
EBITDA (Thurso) (US\$millions)	(0.2)	(5.6)
EBITDA (Berlin) (US\$millions)	—	(4.3)
Loss on Pulp Hedge (US\$millions)	—	(3.5)
Total EBITDA	(0.2)	(13.4)
Pulp EBITDA (\$ per tonne)	(1)	(51)
EBITDA Margin ⁽¹⁾	0%	(17%)
Shipments (000 tonnes) ⁽²⁾	234	263
Average Revenue Realized (\$ per tonne) ⁽²⁾	555	505
Average Cash Operating Costs (\$ per tonne) ⁽⁴⁾	551	515
Reference Price (\$ per tonne) ⁽³⁾		
NBHK market pulp	719	654

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

(2) Pulp volumes and average revenues realized include internal sales but exclude pulp hedges.

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

(4) Average cash operating costs are for the Thurso mill only.

In 2007, worldwide hardwood pulp demand increased 4.8% primarily as a result of increased demand in China for eucalyptus pulp. North American hardwood pulp demand increased by 7.0% due in part to shifts at several mills from internal sources to market pulp purchases and some substitution to hardwood from other fibre sources. North American hardwood market pulp capacity decreased by 0.4% due to mill closures and grade mix changes. These market conditions improved pricing in the NBHK market with average benchmark pricing rising by 10% or \$65 per tonne over 2006 to \$719 per tonne.

Fraser Papers directs a portion of its market pulp for internal use. The Company also purchases pulp from third parties to supplement internal production. The amount of pulp purchased from third parties is approximately equal to third party sales of NBHK placing the Company essentially in a balanced position for total market pulp.

The pulp operations generated negative EBITDA of \$0.2 million in 2007 on sales of \$72.9 million. This compares to the previous year's EBITDA loss of \$13.4 million on sales of \$80.1 million. 2006 included an EBITDA loss of \$4.3 million at the Berlin pulp mill which was permanently shut down, and a loss of \$3.5 million on a pulp hedge that expired at the end of 2006. The EBITDA for the Thurso pulp mill improved from an EBITDA loss of \$5.6 million in 2006 to an EBITDA loss of \$0.2 million in the current year. Improved market conditions contributed most of the EBITDA improvement with benchmark pricing improving 10% or \$65 per tonne over 2006. In Canadian dollar terms, Thurso's cash cost remained at CAD\$588 per tonne despite rising energy costs; however, in U.S. dollar terms, Thurso's cash costs increased 7% to \$551 per tonne compared to \$515 per tonne in 2006 due to the strength of the Canadian dollar.

Shipments declined by 11% in 2007, compared to 2006, primarily due to the closure of the Berlin pulp mill in 2006.

Lumber Operations

Lumber operations are comprised of four sawmills: two in New Brunswick and two in northern Maine.

	For Year Ended December 31	
	2007	2006
Sales (US\$millions)	89.0	115.6
EBITDA (US\$millions)	(22.0)	2.0
Less: Impact of duties refund	—	14.4
Adjusted EBITDA	(22.0)	(12.4)
EBITDA (\$ per Mfbm)	(68)	5
EBITDA Margin ⁽²⁾	(25%)	2%
Shipments (Mfbm)	324	377
Average Revenue Realized (\$ per Mfbm)	273	304
Average Cash Operating Cost (\$ per Mfbm) ⁽³⁾	342	336
Reference Price (\$ per Mfbm) ⁽¹⁾		
Boston SPF 2X4 #2&Btr	324	363

(1) Reference prices are from Random Lengths Publication.

(2) EBITDA Margin is EBITDA as a percentage of net sales.

(3) Cash operating costs exclude refunds of Anti-Dumping Duties.

Market conditions continued to be very weak for our lumber operations due primarily to the decline in U.S. housing activity where annual construction starts have declined from their peak of an annualized 2.3 million in January 2006 to an annualized 1.0 million in December 2007. Average benchmark lumber prices (Eastern Boston SPF 2X4) decreased 11% or \$39 per Mfbm from 2006. Consequently, Fraser Papers' net revenue realized decreased 10% compared to 2006.

In 2007, the Company took a total of 54 weeks of market-related downtime at its sawmills compared to 33 weeks of market downtime in 2006. In 2007, Fraser Papers entered into an agreement to secure alternative woodchips for the Edmundston, New Brunswick pulp mill, which enabled us to close the Juniper sawmill for up to eleven months.

The lumber operations generated negative EBITDA of \$22.0 million in 2007 on sales of \$89.0 million. This compared to EBITDA of \$2.0 million in 2006 which included \$14.4 million from anti-dumping duty refunds. Weak market conditions, lower selling prices and market-related shutdowns contributed to the lower results.

Shipments declined by 14% in 2007, compared to 2006, due to the market-related downtime.

Timber Segment

The Company sold its freehold NB Timberlands on January 31, 2006 and currently has only one reportable segment. The table shown below reflects only the results of operating the Timber segment during the first quarter of 2006.

(US\$millions)	For Year Ended December 31	
	2007	2006
Net sales	\$ —	\$ 4.3
EBITDA ⁽¹⁾	—	2.4
Depreciation	—	—
Capital investments	—	—

(1) See "Definitions" Section.

CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES

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

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

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

Revenue recognition

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

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 regularly 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

Operating Cash Flows

During 2007, cash flow from operations before changes in working capital was an outflow of \$67.6 million as compared to an outflow of \$44.3 million during 2006. The higher cash outflow was due to higher EBITDA losses and higher net interest expense partly offset by the fact that fewer payments related to Smart Papers were required in 2007 as compared to 2006.

During 2007, Fraser Papers decreased working capital by \$17.1 million. Finished goods inventories increased as a result of our improved penetration of specialty paper markets, which demand a higher service component. However, these increases were more than offset by a reduction in accounts receivable, as a result of better collections and an increase in accounts payable and accrued liabilities. In 2006, the Company increased working capital by \$21.0 million.

Capital Investments

Capital investments in 2007 totaled \$18.0 million compared to \$12.7 million for 2006. During the second quarter, we invested \$9.2 million to rebuild the recovery boiler at the Edmundston pulp mill facility. The rebuild increased production at the Company's sulphite pulp mill and reduced the requirement to purchase higher priced market pulp from third parties. The remaining \$8.8 million was directed toward capital investments necessary to maintain our operations.

Net Debt and Share Capital

During 2007, the Company repaid the remaining \$84.0 million in principal amount of its outstanding Notes. The Company repaid \$68.5 million of Notes to the public and cancelled \$15.5 million of Notes held by Fraser Papers. The Notes were issued in 2005 in the principal sum of \$150.0 million. \$66.0 million of Notes were repaid in 2006 including the cancellation of \$14.5 million of Notes held by Fraser Papers. During 2006, Fraser Papers purchased Notes in the principal amount of \$30.0 million for total proceeds of \$25.9 million, resulting in a gain of \$3.1 million, net of a write-down in debt issuance costs of \$1.0 million.

The Company temporarily increased its revolving credit facility with its current lender from \$90.0 million to \$140.0 million in order to finance the repayment of the Notes. The \$50.0 million increase, with a maturity date of January 31, 2008, was on substantially the same terms as the Company's existing facility.

The current portion of long-term debt at December 31, 2007 of \$81.6 million consisted of borrowings under the Company's committed, revolving credit facility. At year end, an additional \$42.3 million of this facility was utilized in support of letters of credit.

Net debt including bank indebtedness as of December 31, 2007 was \$85.9 million, resulting in a net debt to net debt plus equity ratio of 23%.

During 2007, Fraser Papers announced the Offering under which the Company granted its existing shareholders the right to purchase 20,656,913 shares at a purchase price of CAD\$2.90 per share. Subsequent to year end, the Company issued 20,656,913 common shares and received proceeds of C\$59.9 million. Proceeds were used to pay outstanding indebtedness including the temporary \$50.0 million financing under the revolving credit facility.

Taxation Matters

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

As at December 31, 2007, Fraser Papers had tax loss carry-forwards of \$272.3 million in the U.S. and \$63.3 million in Canada. These carry-forwards expire between 2014 and 2027 and are available to reduce income taxes otherwise payable in future years. The Company has recorded a valuation allowance against the losses in the U.S. to the extent that it is not more likely than not that the benefit of the losses will be realized.

Asset Retirement Obligations

Asset retirement obligations relate primarily to closure costs and post-closure maintenance costs for landfills. The liability is reflected in other liabilities on our Consolidated Balance Sheet at the discounted value of expected future cash flows. The liability associated with these obligations is reduced as these obligations are paid and the asset associated with these obligations is depreciated over the estimated useful life of the related facility. The obligations represent estimated future payments of \$30.1 million which have been discounted at a weighted average rate of 8.2%. Total accretion expense for the year related to asset retirement obligations was \$0.7 million compared to \$0.6 million in 2006. 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.

Employee Benefit Plans

Our obligations under our defined benefit pension plans are determined periodically through actuarial valuations, which are the basis for calculating pension expense and determining pension funding. At December 31, 2007, defined benefit pension plan assets were \$530.5 million, up from \$475.4 million in 2006, while the benefit obligations of \$643.0 million were higher than the \$588.0 million of obligations in 2006. At December 31, 2007, the unfunded pension liability was \$112.5 million, substantially unchanged from the \$112.6 million of unfunded liability at December 31, 2006. The funded status of our defined benefit pension plans is 83% at the end of 2007 compared to 81% in 2006.

Defined benefit pension expense of \$11.6 million decreased from the \$19.0 million recorded in 2006 primarily due to higher returns on invested assets. Funding for the year was \$25.0 million down from \$33.5 million funded in 2006. Our defined benefit pension plans are funded in accordance with all applicable regulatory requirements. For 2008, we anticipate slightly lower pension funding as a result of a better funded position.

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 5.42% as compared to 5.20% in 2006, 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, 2007 Unfunded Liability	Impact on 2007 Pension Expense
Return on assets	\$5.3 million increase	\$5.3 million increase
Discount rate	\$75.3 million increase	\$6.2 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, 2007, the accrued benefit obligations of these plans were \$60.7 million compared to \$62.1 million at the end of 2006.

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.

Contractual Obligations

The following table presents the total contractual obligations for which cash flows are fixed or determinable as of December 31, 2007:

(US\$millions)	Total	Less than one year	One to three years	Four to five years	After five years
Debt	\$ 81.6	\$ 81.6	\$ —	\$ —	\$ —
Operating leases	1.0	0.6	0.4	—	—
Purchase obligations	10.9	10.9	—	—	—
Total contractual obligations	\$ 93.5	\$ 93.1	\$ 0.4	\$ —	\$ —

Obligations under operating leases include future payments for office facilities and equipment leases. The purchase obligations are commitments for the purchase of energy and raw materials.

Norbord Inc. (a related party by virtue of a common significant shareholder) provides guarantees for certain obligations of Fraser Papers under a financial commitments agreement. At December 31, 2007, the maximum potential amount of the obligations guaranteed was estimated to be \$4.4 million. These guarantees have not been included in the table above.

Fraser Papers has been given approvals to temporarily transfer its Crown cutting rights and rights under a fibre supply agreement with Acadian to a third party. While the third party has agreed to pay the full costs associated with these transfers, the Company retains the legal obligation to pay the Province of New Brunswick or Acadian should the third party not honour its obligation. As at December 31, 2007, the maximum potential amount of the obligation is \$3.7 million.

Hedging Activities

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

Effective January 1, 2007, the Company adopted new recommendations of the Canadian Institute of Chartered Accountants (“CICA”) under CICA Handbook Section 1530, Comprehensive Income, and Section 3865, Hedges. These policy changes were adopted on a prospective basis with no restatement of prior period financial statements. As a result of the adoption of these new standards, changes in the value of instruments reported at fair value and fair value hedge derivatives are recognized in income. Changes in the value of derivatives designated as cash flow hedges are recognized in other comprehensive income until the instrument is no longer recognized or impaired and is recognized in income.

During 2007, Fraser Papers realized a net gain of \$0.6 million on lumber futures contracts to deliver 17.9 million board feet of lumber at fixed prices. There were no contracts outstanding at the end of the year.

The Company enters into forward contracts to fix the exchange rate on its Canadian dollar-denominated net liabilities and certain Canadian dollar-denominated cash flows.

As of December 31, 2007, the Company had CAD\$30.0 million in foreign exchange contracts outstanding as a fair value hedge against certain Canadian dollar-denominated net monetary liabilities. During the year, the Company realized \$8.0 million of gains on these contracts and at December 31, 2007, the unrealized gains on these contracts amounted to \$0.2 million.

As of December 31, 2007, the Company had \$60.0 million in forward foreign exchange contracts outstanding as a hedge of anticipated future Canadian dollar cash inflows and \$42.4 as a hedge of anticipated future Canadian dollar cash outflows. These contracts have varying maturity dates in 2008. During the year, the Company realized \$2.5 million of gains related to foreign exchange contracts and at December 31, 2007, the unrealized gains on outstanding contracts amounted to \$0.4 million.

OFF-BALANCE SHEET ARRANGEMENTS

We have no material off-balance sheet arrangements.

COMMON SHARES

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

The weighted average number of shares outstanding used for calculating loss per share was 29,509,876 for 2007 unchanged from 2006.

Common Share Information	December 31, 2007	December 31, 2006
Shares outstanding	29,509,876	29,509,876
Book value	\$9.83	\$11.25
Market price at year-end	CAD\$2.68	CAD\$6.19
Market price at February 5, 2008	CAD\$3.14	

In 2007, the Company distributed rights to existing shareholders to purchase 20,656,913 shares at a price of CAD\$2.90 per share. Subsequent to year-end, the Company issued 20,656,913 shares and received gross proceeds of CAD\$59.9 million.

DIVIDENDS

We paid no dividends in 2007. 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 2007, the Board approved the issuance to certain executives of 1,015,000 options with a strike price of CAD\$5.99. During 2006, the Board approved the issuance to certain executives of 485,000 options with a strike price of CAD\$8.04. In 2007 we recognized \$0.9 million in expense related to stock options compared to \$0.6 million in 2006.

The Company has two deferred share unit plans which provide certain directors and senior officers of the Company with an opportunity to invest a portion of their compensation in deferred share units. Deferred share units may be subject to vesting periods. Payments under the plans are made in cash only. The total number of deferred share units outstanding at December 31, 2007 was 617,680. During the year, the Company's obligation under these plans was reduced by \$0.5 million, as the impact of the decline in the Company's share price was greater than the amortized expense of the deferred share units.

TRANSACTIONS WITH RELATED PARTIES

Fraser Papers purchased \$5.7 million of electricity for its Gorham paper mill, from Brookfield and its affiliates in 2007, compared to \$10.4 million in 2006.

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

During the year, Fraser Papers sold \$3.3 million of goods and services to Katahdin and earned a management fee of \$8.0 million. In 2006, Fraser Papers sold \$2.5 million of goods and services to Katahdin and earned a management fee of \$7.8 million.

The Company entered into a 20 year Fibre Supply Agreement with Acadian. Fibre purchases from the Fund during 2007 were \$33.6 million compared to \$34.9 million in 2006. The Company paid \$0.8 million to Acadian as a fee for administering the Company's Crown Licenses. During the year, the Company recognized equity in earnings of the Fund of \$2.3 million and distributions received from the Fund were \$2.3 million.

The Company sold its interest in Acadian on September 26, 2007. Of the 3,613,780 units sold, 2,600,000 were sold to Brookfield for net proceeds of \$27.6 million.

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

Brookfield has provided the Company with a facility with a notional amount of \$200 million to enter into forward foreign exchange contracts as part of the Company's hedging activities. At December 31, 2007, the Company has entered into forward foreign exchange contracts of CAD\$30.0 million as a hedge against certain Canadian dollar-denominated net monetary liabilities, compared to CAD\$57.0 million in 2006. In addition, Fraser Papers held \$60.0 million as a hedge of anticipated future

Canadian dollar cash inflows and \$35.2 million as a hedge of anticipated future Canadian dollar cash outflows, under this facility. At December 31, 2006, Fraser Papers held \$20.7 million as a hedge on anticipated future Canadian dollar cash outflows.

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 2007, the following table shows the approximate annualized impact on after tax earnings of changes in product prices.

	Sensitivity Factor	Impact on Earnings (US\$millions)	Impact on EBITDA (US\$millions)	Average Mill Nets Q4, 2007
Uncoated freesheet	\$25 per ton	\$ 9.4	\$ 6.2	\$ 1,003
Groundwood paper	\$25 per ton	4.4	2.9	787
Market pulp	\$25 per tonne	0.2	0.1	582
Lumber	\$10 per Mfbm	3.2	2.1	264

Competition

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

Foreign Exchange

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

Our foreign exchange exposure arises from the following sources:

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

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 volatility of future Canadian dollar-denominated cash flows. In 2007, 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\$0.93 compared to US\$0.88 in 2006 on our approximately CAD\$390 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 \$2.6 million in 2007. We estimate that the actual impact of the strengthening Canadian dollar amounted to a \$20.1 million decrease in EBITDA compared to 2006.

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.

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.

CONTROLS AND PROCEDURES

Management has designed internal controls over financial reporting, or caused them to be designed under the supervision of the CEO and the CFO, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of these financial statements in accordance with Canadian GAAP. The CEO and CFO considered the need to disclose in this MD&A any change in the Company's internal control over financial reporting that occurred during the Company's most recent interim period that has materially affected, or is reasonably likely to materially affect, the Company's internal control and have not identified any such changes.

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the CEO and CFO, on a timely basis so that appropriate decisions can be made regarding annual and interim financial statement disclosure.

An evaluation of the effectiveness of the design and operation of disclosure controls and procedures was conducted as of December 31, 2007, by management, including the CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that Fraser Papers' disclosure controls and procedures as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuer's Annual and Interim Filings, are effective.

FORWARD-LOOKING INFORMATION

This report contains forward-looking information and statements relating but not limited to, anticipated or prospective financial performance, results of operations, business prospects, expected pension funding, anticipated selling prices for products, maximum possible amounts under certain guarantees and Fraser Papers' strategies. Examples of such statements included in this document include, but are not limited to, the expected improvements in results following restructuring and other initiatives, expected changes in significant cash flows, note repurchases, potential recoveries and adjustments with the Madawaska paper machine closures, strategic and operational intentions and others.

Forward-looking information typically contains statements with words such as "consider", "anticipate", "believe", "expect", "plan", "intend", "likely", "will", "could", "seek", "estimate", "possible", "foresee", "feel", "can", "continue", "potential" or similar words, or variations of those 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 impact Fraser Papers' business and future performance are discussed in the 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

Fraser Papers, like other Canadian forest product companies, is operating in a challenging business environment. During 2007 oil prices reached unprecedented highs; the Canadian dollar appreciated 18% closing the year above par; realized prices for lumber were at their lowest levels in twenty years; and the availability of woodchips reached critical levels in New Brunswick as a result of sawmill closures. These and other factors have served to offset the positive strides made by Fraser Papers in 2007.

Management believes, however, that the positive efforts of the Company and its employees have positioned Fraser Papers to benefit significantly as these pressures ease. In addition, the broad trend of consolidations in the paper industry, are expected to improve the balance of supply and demand.

The closure of two higher cost paper machines in 2007 at the Company's East Papers operations will allow the Company to lower cost and focus on growing its position in target niche segments. Specifically, the Company's proven product development and lightweight coated and uncoated freesheet capabilities will provide opportunities for growth in food packaging applications as consumer preferences move toward "greener", recyclable, paper-based products. Increased bleaching capabilities will allow the Company to enhance its position in specialty high-bright groundwood papers which are expected to displace higher cost, uncoated freesheet grades in certain applications.

The Company will continue to reduce its reliance on commodity freesheet and groundwood markets, however the Company's manufacturing flexibility does allow for opportunistic participation in these markets.

During the fourth quarter, the Company announced price increases to its customers representing almost 50% of its anticipated 2008 paper shipments. Recent capacity reductions for a number of commodity and specialty grades appear to have brought better balance to the markets. The first quarter is traditionally a strong quarter for paper shipments due to the financial printing season and seasonal changes to food and consumer packaging design.

Market fundamentals for NBHK pulp continue to be strong. Recent greenfield start-ups and labour-related restarts appear to have been absorbed into the market as price increases have been announced for 2008. Recent concerns of an economic slowdown in U.S. markets, however, could soften paper demand in these markets.

DEFINITIONS

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

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

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

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

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

EBITDA (US\$millions)	Year Ended December 31,	
	2007	2006
Loss	\$ (43.7)	\$ (113.8)
Add: Interest expense, net	6.8	5.9
Less: Income tax recovery	(13.4)	(15.9)
Less: Gain on sale of timberlands assets	(38.4)	(71.0)
Add: Restructuring Charges	15.9	—
Add: Losses from Smart Papers	—	111.4
Add: Closure of Berlin pulp mill	—	50.3
Add: Other	(0.8)	(5.5)
Add: Depreciation	29.5	31.4
EBITDA	\$ (44.1)	\$ (7.2)

Net Debt (US\$millions)	Year Ended December 31,	
	2007	2006
Long-term debt	\$ —	\$ 66.6
Less: Cash and short-term notes	—	(12.7)
Add: Bank indebtedness	4.3	—
Add: Borrowings under Credit facility	81.6	—
Net debt	\$ 85.9	\$ 53.9

Cash Cost (US\$millions)	Year Ended December 31,	
	2007	2006
Net sales	\$ 714.7	\$ 795.9
Less: EBITDA	44.1	7.2
Add: Anti-dumping duties recovery	—	14.4
Cash cost	\$ 758.8	\$ 817.5

Management's Responsibility for the Financial Statements

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

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

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

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



Peter Gordon
President and Chief Executive Officer

February 4, 2008



Glen McMillan
Senior Vice President and Chief Financial Officer

Auditors' Report

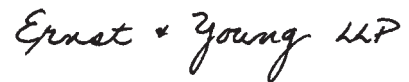
To the Shareholders of Fraser Papers Inc.

We have audited the consolidated balance sheets of Fraser Papers Inc. (the "Company") as at December 31, 2007 and 2006, and the consolidated statements of operations, deficit, comprehensive loss and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
February 4, 2008

The logo for Ernst & Young LLP is written in a cursive, handwritten style. The words "Ernst & Young" are in a larger font, and "LLP" is smaller and positioned to the right.

Chartered Accountants
Licensed Public Accountants

Consolidated Balance Sheets

As at December 31
(US\$millions)

	2007	2006
Assets		
Current assets		
Cash and cash equivalents	\$ —	\$ 12.7
Accounts receivable	99.1	106.2
Inventory (note 4)	125.0	118.3
Future income taxes (note 10)	0.2	0.7
	224.3	237.9
Property, plant and equipment (note 5)	262.3	279.1
Other assets (note 6)	56.5	37.2
	\$ 543.1	\$ 554.2
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness	\$ 4.3	\$ —
Accounts payable and accrued liabilities	106.4	86.3
Current portion of long-term debt (note 7)	81.6	—
	192.3	86.3
Long-term debt (note 7)	—	66.6
Other liabilities (note 8)	56.1	51.1
Future income taxes (note 10)	4.5	18.3
Shareholders' equity (note 11)	290.2	331.9
	\$ 543.1	\$ 554.2

(See accompanying notes)

On behalf of the Board,



Paul Gagné, CA
Audit Committee Chair



Peter Gordon
President and Chief Executive Officer

Consolidated Statements of Operations and Deficit

Years ended December 31

(US\$millions, except per share amounts)

	2007	2006
Net sales	\$ 714.7	\$ 795.9
Loss before the following:		
Paper	(44.1)	(9.6)
Timber	—	2.4
	(44.1)	(7.2)
Gain on sale of timberland assets (note 3)	38.4	71.0
Restructuring charges (note 2)	(15.9)	—
Losses from Smart Papers (note 16)	—	(111.4)
Closure of pulp mill (note 17)	—	(50.3)
Other	0.8	5.5
Interest income	0.5	3.8
Interest expense	(7.3)	(9.7)
Loss before depreciation and income taxes	(27.6)	(98.3)
Depreciation	(29.5)	(31.4)
Income tax recovery (note 10)	13.4	15.9
Loss	\$ (43.7)	\$ (113.8)
Loss per share – basic and diluted	\$ (1.48)	\$ (3.86)
Deficit		
Balance, beginning of year	\$ (162.0)	\$ (48.2)
Loss	(43.7)	(113.8)
Balance, end of year	\$ (205.7)	\$ (162.0)

(See accompanying notes)

Consolidated Statement of Comprehensive Loss and Accumulated Other Comprehensive Income

Year ended December 31
(US\$millions)

	2007
Loss:	\$ (43.7)
Changes in unrealized net gains on cash flow hedges	0.6
Tax impact	(0.2)
Other comprehensive income	0.4
Comprehensive loss	\$ (43.3)
Accumulated other comprehensive income	
Balance, beginning of year	\$ —
Transition adjustment	(0.2)
Other comprehensive income for the year	0.4
Balance, end of year	\$ 0.2

(See accompanying notes)

Consolidated Statements of Cash Flows

Years ended December 31
(US\$millions)

	2007	2006
Cash provided by (used for):		
Operating Activities		
Loss	\$ (43.7)	\$ (113.8)
Items not affecting cash:		
Depreciation	29.5	31.4
Future income taxes (note 10)	(14.8)	(16.8)
Gain on sale of timberlands assets (note 3)	(38.4)	(71.0)
Restructuring charges (note 2)	15.9	—
Losses from Smart Papers (note 16)	—	111.4
Closure of pulp mill (note 17)	—	50.3
Employment benefit plan expense (note 9)	10.8	21.0
Other	1.6	(19.8)
Employment benefit plan funding (note 9)	(28.5)	(37.0)
	(67.6)	(44.3)
Net change in non-cash working capital balances (note 12)	17.1	(21.0)
	(50.5)	(65.3)
Investing Activities		
Capital investments	(18.0)	(12.7)
Proceeds on sale of timberland assets (note 3)	38.4	93.5
	20.4	80.8
Financing Activities		
Borrowings under revolving credit facility (note 7)	81.6	—
Repayment of long-term debt (note 7)	(68.5)	(51.5)
Purchase of long-term debt (note 7)	—	(25.9)
	13.1	(77.4)
Decrease in cash and cash equivalents	\$ (17.0)	\$ (61.9)

(See accompanying notes)

Notes to the Consolidated Financial Statements

(US\$millions, unless otherwise noted)

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

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

Use of Estimates

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

Cash and Cash Equivalents

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

Valuation of Inventories

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

Property, Plant and Equipment

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

Buildings	20 to 40 years
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

Prior to the sale of Fraser Papers’ timberlands, silviculture costs on owned timberlands were capitalized. Depletion of timber was recorded in a systematic manner based on the utilization of timber resources.

Interest costs directly related to major capital projects are capitalized during construction. Costs, net of revenues, incurred during the start-up period of major capital projects are deferred as other assets and amortized over the first three years of the life of the project.

Impairment of Long-Lived Assets

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

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

Employee Future Benefits

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

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

Asset Retirement Obligations

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

Revenue Recognition

Net sales are 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 relevant terms.

Translation of Foreign Currencies

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

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

Stock-based Compensation

The Company issues stock options pursuant to a stock option plan, which is described in Note 11. The Company accounts for stock options using the fair value method. Under this method, compensation expense for stock options is measured at fair value at the grant date using the Black-Scholes valuation model and is recognized over the vesting period of the options granted.

The Company has two deferred share unit plans which provide certain directors and senior officers of the Company with an opportunity to invest a portion of their compensation in deferred stock units. Deferred stock units 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 measured based on the fair value of the vested units which is based on the current market price of the shares of the Company.

Financial Instruments

Effective January 1, 2007, the Company adopted new recommendations of the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook Section 1530, *Comprehensive Income*, Section 3251, *Equity*, Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3861, *Financial Instruments – Disclosure and Presentation* and Section 3865, *Hedges*. With the exception of the reclassification of transaction costs, as described below, these policy changes were adopted on a prospective basis with no restatement of prior period financial statements.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents as held-for-trading for accounting purposes and are measured on the balance sheet at fair value. Accounts receivable are classified as loans and receivables and are measured at amortized cost. The Company's interest in Katahdin Paper Company LLC ("Katahdin") is classified as an available-for-sale investment, but does not have a quoted market price and is measured at cost. Bank indebtedness, accounts payable and accrued liabilities and long-term debt are also measured at amortized cost and are

classified as other financial liabilities. The 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.

Section 3855 also provides guidance on costs incurred upon issuance of financial liabilities. As a result, the carrying value of unamortized financing costs of \$1.9 relating to the Company's 8.75% senior, unsecured notes ("the Notes"), previously recorded in other assets, were reclassified against long-term debt as at December 31, 2006.

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

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

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

Emerging Accounting Pronouncements

On December 1, 2006, the CICA issued new accounting standards: *Capital Disclosures and Financial Instruments – Disclosures and Financial Instruments – Presentation*. Effective January 1, 2008, the Company will disclose additional quantitative and qualitative information that is intended to provide readers of the financial statements with further disclosures on the Company's risks associated with financial instruments and its management of capital.

In June 2007, the CICA issued Handbook Section 3031, *Inventories* which provides additional guidance in the measurement and disclosure requirements for inventory. The CICA also amended Handbook Section 3061, *Property, Plant and Equipment* to require the Company to reclassify long-term operating and maintenance supplies from inventory to property, plant and equipment. These changes apply to interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The transitional provisions provide an entity with the option to either apply these changes retrospectively and restate prior periods or adjust opening retained earnings and not restate prior periods.

The Company is currently reviewing the impact of these new standards on the presentation of the Company's consolidated financial statements.

NOTE 2. CLOSURE OF PAPER MANUFACTURING CAPACITY

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

NOTE 3. SALE OF TIMBERLAND AND OTHER ASSETS

During 2006, the Company sold its timberland assets in New Brunswick (the "NB Timberlands") to the Acadian Timber Income Fund ("Acadian" or the "Fund"), a newly formed income fund. Acadian is a related party by virtue of a common significant shareholder, namely Brookfield.

Net proceeds on the sale of the NB Timberlands were \$125.0, including \$31.5 of securities representing a 30% interest in the equity of the Fund, or a 22% interest in the Fund on a fully diluted basis.

The sale of the NB Timberlands resulted in a gain of \$71.0. In accordance with GAAP, the gain on the sale was the result of net cash proceeds of \$93.5 adjusted for the proportionate share of the net liabilities of the Fund (excluding those related to the NB Timberlands) and the net assets contributed to the Fund (net of Fraser Papers' retained interest).

During 2007, Fraser Papers sold its interest in Acadian for net proceeds of \$38.4. As the units in Acadian had a book value of nil, a gain of \$38.4 was recorded on the transaction.

During the year the Company received distributions from its interest in Acadian of \$2.3 (2006 – \$2.2).

During 2006, the Company sold non-core assets for net proceeds of \$1.7, recording a gain of \$1.7.

NOTE 4. INVENTORY

	2007	2006
Raw materials	\$ 35.4	\$ 33.7
Finished goods	58.2	50.7
Operating and maintenance supplies	31.4	33.9
	\$ 125.0	\$ 118.3

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

2007	Cost	Accumulated Depreciation	Net Book Value
Pulp and paper mills	\$ 882.6	\$ (645.0)	\$ 237.6
Sawmills	117.7	(93.0)	24.7
	\$ 1,000.3	\$ (738.0)	\$ 262.3

2006	Cost	Accumulated Depreciation	Net Book Value
Pulp and paper mills	\$ 905.6	\$ (655.9)	\$ 249.7
Sawmills	116.3	(86.9)	29.4
	\$ 1,021.9	\$ (742.8)	\$ 279.1

NOTE 6. OTHER ASSETS

	2007	2006
Pension plans (<i>note 9</i>)	\$ 43.2	\$ 25.7
Investment in Katahdin Paper Company LLC (<i>note 15</i>)	12.1	11.5
Deferred costs and other	1.2	—
	\$ 56.5	\$ 37.2

NOTE 7. LONG-TERM DEBT

During 2007, the Company amended its existing revolving credit facility to provide for an increase in amounts available from \$90.0 to \$140.0 in order to finance the repayment of \$68.5 of Notes. The facility bears interest at market rates. \$50.0 of the facility matures January 31, 2008 and the remaining balance of \$90.0 is due November 30, 2008. Borrowings under the facility are secured by a first charge against accounts receivable and inventory. At December 31, 2007, \$123.9 (2006 – \$39.5) of the facility was utilized, \$31.6 (2006 – nil) for operating bank loans, \$50.0 under the temporary financing due January 31, 2008 and the balance in the form of letters of credit.

In the fourth quarter of 2007, the Company filed a final short form prospectus with securities regulators in Canada relating to a rights offering (the "Offering"). Subsequent to year end, the Company issued 20,656,913 shares, under the Offering, receiving proceeds of CAD\$59.9 and repaid the \$50.0 temporary financing before the January 31, 2008 due date.

During the year, the Company closed its tender offer to repay all of its Notes of \$84.0 (2006 – \$66.0). The Company repaid \$68.5 (2006 – \$51.5) of Notes to the public and cancelled \$15.5 (2006 – \$14.5) of Notes held by Fraser Papers. A write-down of deferred financing costs of \$1.6 (2006 – \$1.5), related to the repayment under the tender offer, has been reflected in the Consolidated Statements of Operations and Statements of Cash Flows.

During 2006, prior to repaying the Notes, the Company purchased \$30.0 in principal amount of Notes in the market. The Notes were purchased for \$25.9, resulting in a gain of \$3.1, net of a write-down in debt issuance costs of \$1.0. The net gain is reflected in the Consolidated Statements of Operations.

During the year, the Company made interest payments of \$8.9 (2006 – \$10.8).

NOTE 8. OTHER LIABILITIES

	2007	2006
Post-retirement benefit plans (note 9)	\$ 44.2	\$ 41.3
Asset retirement obligations	10.8	7.4
Deferred revenue and other	1.1	2.4
	\$ 56.1	\$ 51.1

Asset retirement obligations relate primarily to closure costs and post-closure maintenance costs for landfills at Fraser Papers' operating locations. The obligations represent estimated future payments of \$30.1 (2006 – \$24.1) which have been discounted at a weighted average rate of 8.2%. Total accretion expense for the year related to asset retirement obligations was \$0.7 (2006 – \$0.6). 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 9. EMPLOYEE BENEFIT PLANS

Pension Plans

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

	2007	2006
Change in Accrued Benefit Obligation During the Year:		
Accrued benefit obligation, beginning of year	\$ 588.0	\$ 590.0
Employee contributions	2.2	2.1
Current service cost	8.2	8.5
Interest on accrued benefit obligation	31.9	30.5
Benefits paid	(46.5)	(39.8)
Net actuarial gain	(19.5)	(4.8)
Restructuring (note 2)	2.8	1.3
Foreign currency exchange rate impact	75.9	0.2
Accrued benefit obligation, end of year ⁽¹⁾	\$ 643.0	\$ 588.0
Change in Plan Assets During the Year:		
Plan assets, beginning of year	\$ 475.4	\$ 414.7
Actual return on plan assets	14.9	66.1
Employer contributions	25.0	33.5
Employee contributions	2.2	2.1
Benefits paid	(46.5)	(39.8)
Foreign currency exchange rate impact	59.5	(1.2)
Plan assets, end of year ⁽¹⁾	\$ 530.5	\$ 475.4
Reconciliation of Funded Status:		
Accrued benefit obligation	\$ 643.0	\$ 588.0
Plan assets	530.5	475.4
Accrued benefit obligation in excess of plan assets	(112.5)	(112.6)
Unamortized net actuarial loss	155.4	137.1
Unamortized prior service costs	7.3	8.2
Unamortized net transitional asset	(7.0)	(7.0)
Net accrued benefit asset	\$ 43.2	\$ 25.7

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

	2007	2006
Components of Net Pension Expense:		
Current service cost	\$ 8.2	\$ 8.5
Interest on accrued benefit obligation	31.9	30.5
Actual return on plan assets	(14.9)	(66.1)
Net actuarial gain	(19.5)	(4.8)
Restructuring (<i>note 2</i>)	2.8	1.3
Difference between actual and expected return on plan assets	(24.9)	32.4
Difference between actual and recognized net actuarial loss	27.6	16.8
Difference between actual and recognized prior service costs	1.5	1.3
Amortization of net transitional asset	(1.1)	(0.9)
Net periodic pension expense	\$ 11.6	\$ 19.0

The net actuarial gain of \$19.5 is primarily the result of a change in the rate used to discount the accrued benefit obligations.

	2007	2006
Significant Weighted-Average Actuarial Assumptions:		
Used in calculation of net periodic pension expense for the year:		
Discount rate	5.17%	5.14%
Expected long-term rate of return on plan assets	8.00%	8.00%
Rate of compensation increase	3.81%	3.75%
Used in calculation of accrued benefit obligation, end of year:		
Discount rate	5.42%	5.20%
Rate of compensation increase	3.81%	3.82%

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

Asset category:		
Equity investments	69%	73%
Fixed income investments	31%	27%
Total assets	100%	100%

The Consolidated Statements of Operations include \$2.7 (2006 – \$3.0) 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:

	2007	2006
Change in Accrued Benefit Obligation During the Year:		
Accrued benefit obligation, beginning of year	\$ 62.1	\$ 64.2
Current service cost	0.6	0.7
Interest on accrued benefit obligation	3.4	3.2
Benefits paid	(3.5)	(3.5)
Net actuarial gain	(9.1)	(0.2)
Plan amendment	1.3	—
Restructuring (<i>note 2</i>)	0.5	(2.3)
Foreign currency exchange rate impact	5.4	—
Accrued benefit obligation, end of year	\$ 60.7	\$ 62.1
Reconciliation of Funded Status:		
Accrued benefit obligation	\$ 60.7	\$ 62.1
Plan assets	—	—
Accrued benefit obligation in excess of plan assets	(60.7)	(62.1)
Unamortized net actuarial loss	18.1	27.2
Unamortized prior service cost	(1.6)	(6.4)
Net accrued benefit liability	\$ (44.2)	\$ (41.3)

	2007	2006
Components of Net Post-retirement Benefit Expense:		
Current service cost	\$ 0.6	\$ 0.7
Interest on accrued benefit obligation	3.4	3.2
Net actuarial gain	(9.1)	(0.2)
Difference between actual and recognized net actuarial loss	10.6	1.8
Difference between actual and recognized prior service losses	(3.5)	(3.5)
Restructuring (note 2)	0.5	—
Net periodic post-retirement benefit expense	\$ 2.5	\$ 2.0
Significant Weighted-Average Actuarial Assumptions:		
Used in calculation of net post-retirement benefit expense for the year:		
Discount rate	5.33%	5.24%
Used in calculation of accrued benefit obligation, end of year:		
Discount rate	5.58%	5.37%
Health care cost trend rate used in calculation of accrued benefit obligation, end of year:		
Initial rate	9.78%	9.51%
Ultimate rate	5.00%	5.00%
Year ultimate rate reached	2016	2014
Sensitivity to change in health care cost trend rate, for year ended December 31, 2007:	1% increase	1% increase
Impact on net periodic post-retirement benefit expense	0.5	0.5
Impact on accrued benefit obligation	7.0	7.3

NOTE 10. 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:

	2007	2006
Current tax expense	\$ (1.4)	\$ (0.9)
Future income tax recovery	14.8	16.8
Income tax recovery	\$ 13.4	\$ 15.9

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

	2007	2006
Loss before income taxes	\$ (57.1)	\$ (129.7)
Tax recovery at combined statutory rates	19.1	45.1
Effect of:		
Rate differences on different jurisdictions	0.3	17.8
Non-taxable portion of net capital gains	22.5	12.8
Foreign exchange and other	1.7	5.9
Change in valuation allowance	(30.2)	(65.7)
Income tax recovery	\$ 13.4	\$ 15.9

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

	2007	2006
Benefit of tax loss carry forwards	\$ 126.4	\$ 80.3
Post-employment benefits	0.2	5.8
Current future income tax assets	9.0	9.7
Other future income tax assets, net	8.1	5.9
Property, plant and equipment	(45.2)	(46.8)
Future income taxes	\$ 98.5	\$ 54.9
Less: Valuation allowance	(102.8)	(72.5)
Future income taxes, net	\$ (4.3)	\$ (17.6)
Represented by:		
Current future income tax asset	\$ 0.2	\$ 0.7
Long-term future income tax liability	(4.5)	(18.3)
	\$ (4.3)	\$ (17.6)

The benefit of tax loss carry-forwards includes the benefit of \$272.3 (2006 – \$194.4) of net losses in the United States which expire between 2024 and 2027. A valuation allowance of \$102.8 (2006 – \$72.5) has been provided against the benefit of income tax assets as it is not more likely than not that they will be realized. Included in the valuation allowance is \$123.8 of future income tax assets related to these losses, partly offset by \$21.0 of net future income tax liabilities. The Company has \$63.3 (2006 – \$5.1) of loss carry-forwards in Canada which expire between 2014 and 2027.

Income or income-related taxes of \$2.3 (2006 – \$1.3) were paid during the year. Income tax recoverable of \$1.2 (2006 – \$1.5) is included in accounts receivable, as at December 31, 2007.

NOTE 11. SHAREHOLDERS' EQUITY

	2007	2006
Common shares – 29,509,876 outstanding	\$ 490.0	\$ 490.0
Contributed surplus	5.7	3.9
Accumulative other comprehensive income	0.2	—
Deficit	(205.7)	(162.0)
	\$ 290.2	\$ 331.9

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

The weighted average number of shares outstanding used for calculating loss per share was 29,509,876 for 2007 and 2006.

In the fourth quarter of 2007, the Company filed a final short form prospectus with securities regulators in Canada relating to the Offering. Under the Offering, the Company distributed rights to existing shareholders to purchase 20,656,913 shares, at a purchase price of CAD\$2.90. Subsequent to year end, the Company issued 20,656,913 shares and received gross proceeds of CAD\$59.9.

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

	2007	2006
Risk-free interest rate	3.9%	3.9%
Volatility	32.0%	25.0%
Dividend yield	0.0%	0.0%
Expected life	7.5 years	10.0 years

Total compensation expense in 2007 was \$0.9 (2006 – \$0.6) for these stock options.

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

	2007		2006	
	Number of Options	Weighted Average Exercise Price (CAD\$)	Number of Options	Weighted Average Exercise Price (CAD\$)
Balance, beginning of year	730,000	\$ 10.79	245,000	\$ 16.22
Options granted	1,015,000	\$ 5.99	485,000	\$ 8.04
Options cancelled	(115,000)	\$ 9.50	—	—
Balance, end of year	1,630,000	\$ 7.89	730,000	\$ 10.79

The following table summarizes options outstanding and the weighted average exercise price, as at December 31, 2007:

Year granted	Options outstanding			Options vested
	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price (CAD\$)	Number of Options
2004	195,000	6.7	\$ 16.45	117,000
2005	30,000	7.1	14.59	12,000
2006	390,000	8.2	8.04	78,000
2007	1,015,000	9.1	5.99	—
	1,630,000	8.6	\$ 7.89	207,000

NOTE 12. CHANGE IN NON-CASH WORKING CAPITAL

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

	2007	2006
Cash provided by (used for):		
Accounts receivable	\$ 10.6	\$ (8.5)
Inventory	(7.6)	(4.7)
Accounts payable and accrued liabilities	14.1	(7.8)
	\$ 17.1	\$ (21.0)

NOTE 13. FINANCIAL INSTRUMENTS

Foreign Currency Rate Risk

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

As at December 31, 2007, the Company has outstanding forward foreign exchange contracts of CAD\$30.0 (2006 – CAD\$57.0), which are designated as a fair value hedge against certain Canadian dollar-denominated net monetary liabilities. The Consolidated Statements of Operations for the year ended December 31, 2007 include a realized gain of \$8.0 (2006 – \$1.6) on matured forward foreign exchange contracts and an unrealized gain of \$0.2 (2006 – loss of \$0.3) on outstanding contracts. These realized and unrealized gains or losses are offset by realized and unrealized losses or gains on the net monetary liabilities being hedged.

As at December 31, 2007, the Company has forward foreign exchange contracts of \$60.0 (2006 – nil) as a hedge of anticipated future Canadian dollar cash inflows and \$42.4 (2006 – \$20.7) as a hedge of anticipated future Canadian dollar cash outflows. These contracts have varying maturity dates in 2008. The Consolidated Statements of Operations for the year ended December 31, 2007 include a realized gain of \$2.5 (2006 – \$0.1) on matured forward foreign exchange contracts. An unrealized gain of \$0.4 is recorded in other comprehensive income. These contracts effectively fix the exchange rate at which certain future Canadian dollar-denominated cash flows will be incurred.

Commodity Price Risk

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

During the year, Fraser Papers entered into lumber futures contracts which effectively fixed the selling price for lumber delivered on the expiry date and were designated as a hedge of a portion of future lumber sales. During the year, Fraser Papers realized net gains of \$0.6 (2006 – \$1.0) on lumber futures contracts. There were no outstanding contracts at December 31, 2007 and 2006.

In 2006, Fraser Papers was party to a pulp swap to deliver 24,000 tonnes of market pulp. This swap effectively fixed the selling price on a portion of Fraser Papers' production and was designated as a hedge of a portion of its pulp sales. The Company realized losses on these contracts of \$3.5 in 2006. There were no pulp contracts entered into in 2007.

Credit Risk

Fraser Papers does not have a trade receivable balance greater than \$7.9 from any individual customer or counterparty as at December 31, 2007 (2006 – \$11.9). The Company reviews a customer's credit rating before extending or increasing credit and conducts regular reviews of existing customers' credit performance. No amounts were expensed related to bad debts in 2007 (2006 – \$0.2). The allowance for doubtful accounts as at December 31, 2007 is \$0.2 (2006 – \$0.2).

NOTE 14. COMMITMENTS AND CONTINGENCIES

Softwood Lumber Anti-Dumping Duties

Since the inception of the anti-dumping duties imposed by the United States Department of Commerce, the Company paid \$15.7 on the export of lumber to the U.S. In 2006, the Company received refunds and interest of \$14.4 related to anti-dumping duties paid in previous years. These refunds were recognized in the Consolidated Statements of Operations. The Company does not expect any further refunds.

Guarantees

Norbord has provided guarantees for certain obligations of Fraser Papers under a financial commitments agreement (the "FCA"). These guarantees were previously obligations of the paper division of Norbord. At December 31, 2007, the maximum potential amount of the obligations guaranteed was estimated to be \$4.4 (2006 – \$7.0).

Under the FCA, Fraser Papers agreed to provide letters of credit or other acceptable collateral to secure any guarantees outstanding on December 31, 2007. As security for these ongoing financial commitments to Fraser Papers, Norbord has the right, at any time, to require Fraser Papers to provide a fixed first charge security interest over certain of Fraser Papers' manufacturing facilities.

Fraser Papers has been given approvals to temporarily transfer its Crown cutting rights and rights under a fibre supply agreement with Acadian to a third party. While the third party has agreed to pay the full costs associated with these transfers, the Company retains the legal obligation to pay the Province of New Brunswick or Acadian should the third party not honour its obligation. As at December 31, 2007, the maximum potential amount of the obligation is \$3.7.

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, 2007, are:

2008	\$ 15.3
2009	0.9
2010	0.1
Subsequent	—
	<hr/>
	\$ 16.3

NOTE 15. RELATED PARTY TRANSACTIONS

Fraser Papers purchased \$5.7 (2006 – \$10.4) of electricity for its Gorham paper mill, from Brookfield and its affiliates. Included in accounts payable and accrued liabilities is \$0.5 (2006 – \$1.1) related to these purchases.

Fraser Papers has invested in convertible, term, preferred units (the "Units") of Katahdin, an indirectly, wholly owned subsidiary of Brookfield. The Units earn a preferential cumulative distribution of 5% per annum. Cumulative distributions accrued on this investment amount to \$2.1 (2006 – \$1.5).

Fraser Papers has leased certain productive equipment owned by Katahdin. The lease payment amounts are determined with reference to the profits generated by those assets such that all of the profits earned by Fraser Papers on those assets, net of a management fee, are remitted to the lessor as lease payments. During the year, Fraser Papers earned a management fee of \$8.0 (2006 – \$7.8) from Katahdin. Included in accounts receivable is \$2.5 (2006 – \$2.1) related to these fees.

During 2007, Fraser Papers sold \$3.3 (2006 – \$2.5) of goods and services to Katahdin. Included in accounts receivable is \$0.8 (2006 – \$2.0) related to these sales.

The Company entered into 20 year Fibre Supply Agreements with Acadian. During the year, purchases of fibre from the Fund amounted to \$33.6 (2006 – \$34.9). Included in accounts payable and accrued liabilities is \$1.0 (2006 – \$0.1) related to these purchases. The Company paid \$0.8 (2006 – \$1.3) to Acadian as a fee for administering the Company's Crown Licenses. During the year, the Company recognized equity in earnings of the Fund of \$2.3 (2006 – \$2.2) and distributions received from the Fund were \$2.3 (2006 – \$2.2).

As described in Note 3, the Company sold its interest in Acadian on September 26, 2007. Of the 3,613,780 units sold, 2,600,000 were sold to Brookfield, for net proceeds of \$27.6.

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

Brookfield has provided the Company with a facility with a notional amount of \$200.0 to enter into forward foreign exchange contracts as part of the Company's hedging activities. At December 31, 2007, the Company has entered into forward foreign exchange contracts of CAD\$30.0 (2006 – CAD\$57.0) as a hedge against certain Canadian dollar-denominated net monetary liabilities, \$60.0 (2006 – nil) as a hedge of anticipated future Canadian dollar cash inflows and \$35.2 (2006 – \$20.7) as a hedge of anticipated future Canadian dollar cash outflows, under this facility.

NOTE 16. LOSSES FROM SMART PAPERS

Smart Papers LLC and its affiliates ("Smart Papers"), filed for creditor protection under Chapter 11 of the United States Bankruptcy Code, in the first quarter of 2006. As a result, Fraser Papers recorded a charge of \$111.4, consisting of an impairment charge against its investment in Smart Papers of \$74.0, a provision of \$37.4 related to receivables from Smart Papers and estimated accruals. After net payments of \$2.1 in 2007 (2006 – \$16.0) a balance of \$5.2 remains unpaid related to these accruals.

NOTE 17. CLOSURE OF BERLIN PULP MILL

During 2006, Fraser Papers permanently shut down its pulp mill in Berlin, New Hampshire. As a result of the announcement, Fraser Papers recorded a charge of \$50.3 consisting of an impairment in property, plant and equipment and other assets and various accruals.

NOTE 18. SEGMENTED INFORMATION

Geographic Segments

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

	Net Sales		Property, Plant and Equipment	
	2007	2006	2007	2006
United States	\$ 588.7	\$ 648.7	\$ 128.6	\$ 146.9
Canada ⁽¹⁾	126.0	147.2	133.7	132.2
Combined total	\$ 714.7	\$ 795.9	\$ 262.3	\$ 279.1
(1) Export Sales included in total	\$ 84.9	\$ 85.1		

Operating Segments

As a result of the sale of its NB timberlands, Fraser Papers has one reportable segment comprised of its integrated paper, pulp, and sawmill operations.

In determining its reportable segments, Fraser Papers considers that it is an integrated producer of paper and pulp as its principal business. Its sawmill operations are an integral part of its overall business as these facilities provide fibre for the internal production of pulp.

NOTE 19. COMPARATIVE FIGURES

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

Directors and Officers of Fraser Papers

DIRECTORS

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

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

Paul E. Gagné, CA ^{(1) (4) (5)}
Chairman
Wajax Income Fund

Dominic Gammiero
Chairman
Fraser Papers Inc.

J. Peter Gordon
President and Chief Executive Officer
Fraser Papers Inc.

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

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

Margot Northey, Ph.D. ^{(1) (3) (4)}
Corporate Director

Samuel J.B. Pollock, CA ^{(3) (5)}
Managing Partner
Brookfield Asset Management Inc.

OFFICERS

Dominic Gammiero
Chairman

J. Peter Gordon
President and Chief Executive Officer

Glen McMillan
Senior Vice President
and Chief Financial Officer

Jeffrey Dutton
Senior Vice President, Operations
and Chief Operating Officer

William Manzer
Senior Vice President,
Business Strategy and Projects

Brian McAlary
Vice President, Sales

Matthew Nightingale
Vice President, Marketing

Marina Mueller
Assistant Corporate Secretary

Committees of the Board:

- (1) Audit
- (2) Corporate Governance and Nominating
- (3) Environment, Health and Safety
- (4) Human Resources
- (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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Paper sales

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Pulp sales

Telephone (819) 985-5006

SHAREHOLDER INFORMATION

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

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