Estate File No.: #31-457123
Court File No.: #31-457123

IN THE MATTER OF THE BANKRUPTCY OF
ST. MARYS PAPER CORP.
OF THE CITY OF SAULT STE MARIE,
IN THE PROVINCE OF ONTARIO

REPORT OF THE TRUSTEE'S PRELIMINARY ADMINISTRATION OF THE ESTATE OF ST. MARYS PAPER CORP.

DISCLAIMER

1. On June 6, 2012, a bankruptcy order was made against St. Marys Paper Corp. ("**St. Marys**" or the "**Company**") and Ernst & Young Inc. was appointed as the Trustee in Bankruptcy (the "**Trustee**")

2. We present hereunder our Report on the Trustee's Preliminary Administration of the Estate of St. Marys (the "**Report**").

3. In developing the Report, we have relied upon unaudited financial information, Company records and discussions with management and employees of the Company. We have not performed an audit or other verification of such information, and accordingly we express no opinion thereon.

4. The Report has been prepared solely for the use of the Company's creditors (the "**Creditors**"), as general information on the state of affairs of the Company. Given the nature of the Trustee's mandate, this information is preliminary only and is subject to change as the mandate progresses. In light of the foregoing, the Report should not be circulated or used for other purposes or reproduced without our knowledge and prior written permission. We will not assume responsibility or liability for losses incurred by the reader as a result of the circulation, publication, reproduction or use of the Report contrary to the provisions of this paragraph.

COMPANY BACKGROUND

5. St. Marys is a corporation incorporated pursuant to the laws of the Province of Ontario with its head office located in the City of Sault Ste. Marie, Ontario. Prior to March 2011 St. Marys operated a groundwood pulp and super calendar specialty paper mill (the "**Mill**") producing paper grades used mainly by magazine publishers and retailing companies for high quality advertising inserts, flyers and catalogues.

6. In March 2011, St. Marys was forced to shut down the Mill as a result of an unexpected mechanical issue on its largest paper machine. This paper machine provides more than half of its annual output capacity. St. Marys has addressed the mechanical issue, however, due to weaker market conditions, St. Marys decided not to restart the Mill until market conditions improved.

7. Due to the shortage of funds, St. Marys management determined that the Mill should be preserved in a 'cold idle' state until market conditions improved. Accordingly, a process was commenced to winterize the Mill and prepare it for a 'cold idle' shutdown.

8. As a result of the shutdown of the Mill, St. Marys experienced financial difficulties and a significant liquidity crisis. In addition, St. Marys was unable to secure insurance coverage for the Mill and its operations. As a result, on December 30, 2011 Ernst & Young Inc. ("**EYI**") was appointed pursuant to an order of the Superior Court of Justice (the "**Court**") as the receiver and receiver and manager (the "**Receiver**") of all of the assets, undertakings and properties of St. Marys acquired for, or used in relation to the Company's business, including all proceeds thereof (the "**Property**") pursuant to section 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "**BIA**") and section 101 of the *Courts of Justice Act*, R.S.O 1990 c C.43, as amended (the "**Appointment Order**"). A copy of the Appointment Order is available on the Receiver's website at www.ey.com/ca/smp.

SALE OF THE MILL

9. On January 18, 2012, the Court granted an Order (the "**Sales Process Order**") authorizing the Receiver to conduct a process to market and sell the Property of St. Marys (the "**Sales**

Process") as set out in the procedures included in the Sales Process Order (the "**Sales Process Protocol**").

10. Pursuant to the Sales Process Protocol, the Receiver initiated the Sales Process. It was hoped that the Sales Process would identify a purchaser for the Mill that would operate the Mill as a paper mill or an alternative wood products facility, and if no such purchaser was identified, then a liquidation purchaser would be identified.

11. The Sales Process was conducted from January 18, 2012 until March 20, 2012. A total of 177 parties were contacted by the Receiver, including 15 energy related parties, 75 financial parties, 54 strategic parties, and 33 liquidators and other parties. Although 36 parties executed confidentiality agreements and were provided with access to the electronic data room and offered site visits, the Receiver received bids from only nine parties on the date the bids were due, however, none of the bids received of would have generated sufficient proceeds to pay the first secured creditor's debt in full as at the closing of the sale. The Receiver received feedback from certain parties that the costs required to return the Mill to its operating status would likely make it uneconomical to re-start the Mill given the current market conditions in the super calendar paper industry.

12. The sale transaction (the "**Transaction**") contemplated in the agreement of purchase and sale dated March 15, 2012 (the "**Sale Agreement**") between St. Marys, by the Receiver, and 2319839 Ontario Inc. (the "**Purchaser**"), closed on April 4, 2012, and the purchased assets described in the Sale Agreement have vested in the Purchaser as provided by the Order of the Court dated March 26, 2012 (the "**Sale Approval and Vesting Order**").

13. The Purchaser has delivered and paid to the Receiver the purchase price provided under the Sale Agreement.

BANKRUPTCY PROCEEDINGS

14. On May 8, 2012, IFP brought a bankruptcy application (the "**Bankruptcy Application**") with respect to St. Marys, which was granted by the Court on June 6, 2012.

15. On June 11, 2012, packages were mailed to the Creditors listed on St. Marys' Statement of Affairs. The packages included a notice of the bankruptcy and first meeting of creditors, a list of creditors, a proof of claim and a proxy.

16. Copies of the documents are available on the Trustee's website at www.ey.com/ca/smp.

17. On June 15, 2012, a newspaper advertisement was placed in the Sault Star informing Creditors of the bankruptcy and the date and time of the meeting of Creditors.

FINANCIAL POSITION OF THE COMPANY

18. As of the date of the Report, in accordance with the various Court Orders, the Receiver has realized on the majority of the Property. The proceeds generated from the Transaction are insufficient to pay St. Marys' secured creditors in full.

19. Summarized below are St. Marys' assets and liabilities as of June 6, 2012:

Assets	
Deposits in financial institutions controlled by the Receiver	$5,068,276.44
Other Assets (estimated realizable value)	1,110,000.00
Total Assets	**6,178,276.44**
Liabilities	
Secured Creditors	26,925,678.00
Unsecured Creditors	11,381,394.16
Total Liabilities	**$38,307,072.16**

20. St. Marys' remaining assets primarily include its shares in SMP Resources Inc., unused collateral related to certain letters of credit, and cash deposits held by the Receiver.

21. The Receiver has obtained a satisfactory independent legal opinion as to the validity and enforceability of the security held by the first secured lender, International Forest Products LLC ("**IFP**").

22. The Trustee notes that there are insufficient funds to pay the secured creditors in full.

LEGAL PROCEEDINGS

23. The Trustee has not initiated any legal proceedings during its administration of the Bankrupt's estate to date nor is the Trustee aware of any outstanding or pending litigation against the Bankrupt's estate.

24. The Trustee's counsel in these bankruptcy proceedings is Cassels Brock & Blackwell LLP.

PROVABLE CLAIMS

25. A total of 36 claims were filed with the Trustee as of June 19, 2012, as follows:

Secured	$2,000.00
Preferred	0.00
Unsecured	$1,472,788.71
	$1,474,788.71

26. In the event that the Trustee determines that a dividend may become payable to the unsecured Creditors, the Trustee will review the Company's records to reconcile discrepancies, if any, between the Company's records and the proofs of claim filed. However, it is not anticipated that there will be a dividend available to the unsecured Creditors.

PREFERENCES AND TRANSFERS AT UNDERVALUE

27. The Trustee has not conducted a review of any preferences or transactions undervalue.

ANTICIPATED RESULTS AND PROJECTEED DISTRIBUTION

28. As described above, the secured creditors will experience a significant shortfall on their security, therefore it is not expected that there will be any distribution from the Bankrupt's estate for unsecured Creditors.

Dated at Toronto, Ontario this 20th day of June, 2012.

ERNST & YOUNG INC.
Trustee of the Bankrupt Estate of
St. Marys Paper Corp.

Per:

Alex F. Morrison
Senior Vice President