Court File No. CV-09-8062-OOCL

ONTARIO

SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TERRACE BAY PULP INC.

EIGHTEENTH REPORT OF ERNST & YOUNG INC.

DATED AUGUST 24, 2010

INTRODUCTION

1. On March 11, 2009, Terrace Bay Pulp Inc. ("**Terrace Bay**" or the "**Applicant**") filed for and obtained protection under the *Companies' Creditors Arrangement Act* (the "**CCAA**"). Pursuant to an Order of this Honourable Court dated March 11, 2009 (the "**Initial Order**"), Ernst & Young Inc. ("**EYI**") was appointed as Monitor (the "**Monitor**") in this proceeding (the "**CCAA Proceeding**"). The Initial Order provided a period of time during which proceedings against the Applicant and its property were stayed (the "**Stay Period**"). The initial Stay Period expired on April 10, 2009, but has been extended from time to time, most recently by Order of this Honourable Court made on July 27, 2010. Absent a further extension, the Stay Period will expire on August 31, 2010.

PURPOSE

2. The purpose of this eighteenth report of the Monitor (the "**Eighteenth Report**") is to update this Honourable Court in relation to the activities of Terrace Bay and the Monitor since the seventeenth report of the Monitor to this Honourable Court dated July 23, 2010 (the "**Seventeenth Report**") and to report on the following:

    (a) the status of Terrace Bay's restructuring efforts;

(b) the receipts and disbursements for the weeks ending July 23, 2010 through August 15, 2010;

(c) the revised cash flow forecast; and

(d) a proposed extension of the Stay Period.

TERMS OF REFERENCE

3. In preparing this Eighteenth Report, EYI has been provided with and in making the comments herein it has relied upon, unaudited financial information, Terrace Bay's books and records, financial information prepared by Terrace Bay, and discussions with management of Terrace Bay. EYI has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information and, accordingly, EYI expresses no opinion or other form of assurance in respect of such information contained in this Eighteenth Report. Some of the information referred to in this Eighteenth Report consists of forecasts and projections. An examination or review of the financial forecast and projections, as outlined in the Canadian Institute of Chartered Accountants (**"CICA"**) Handbook, has not been performed. Future oriented financial information referred to in this Eighteenth Report was prepared based on management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.

STATUS OF TERRACE BAY'S RESTRUCTURING EFFORTS

4. The Applicant, with the assistance of the Monitor, has continued to work toward the fulfilment of conditions which must be satisfied prior to implementation of the Plan of Arrangement (the **"Plan"**) sanctioned by this Honourable Court on July 27, 2010 (the **"Plan Conditions"**). The Affidavit of Russell York sworn in support of the motion being brought by the Applicant for an extension of the Stay Period (the **"York Affidavit"**) outlines progress that has been made by the Applicant toward satisfying the Plan Conditions.

5. As described in the York Affidavit, substantial progress has been made to conclude matters outstanding in relation to the Plan Conditions. As described below, however, the process of finalizing an operating financing facility is not yet complete.

6. The Applicant executed a term sheet on July 2, 2010 with an asset-based lender (the "**ABL Lender**") to provide operating funding. The Applicant's activities, with the assistance of the Monitor, since that date have focussed on working with the ABL Lender and its advisors to complete the due diligence process and in preparing the related legal documentation to support the transaction.

7. It appears that a financing cannot be completed with the ABL Lender prior to August 31, 2010. Despite considerable efforts undertaken to conclude the due diligence and legal documentation, the Applicant has concluded that to continue to pursue an agreement with the ABL Lender will lead to delays in implementing the Plan, closing the necessary transactions and restarting its operations. Accordingly, the Applicant has entered into a term sheet with a different lender and has begun working with such lender on the due diligence and documentation required to proceed with an asset-based loan transaction with a view to completing a loan transaction in the near future.

8. The Applicant has commenced preliminary activities to ready the mill for restart, although by reason of the delay that has developed in concluding arrangements for an operating loan facility, it is anticipated that certain activities will have to be deferred to reflect a revised anticipated closing date.

9. Accordingly, the Applicant is seeking an extension of the Stay Period through to September 17, 2010 to permit it, with the assistance of the Monitor, to complete the arrangements required to satisfy the Plan Conditions and facilitate a successful restart of the mill.

RECEIPTS AND DISBURSEMENTS THROUGH AUGUST 15, 2010

10. Attached as Appendix **"A"** to this Eighteenth Report is a summary of Terrace Bay's actual receipts and disbursements from July 19, 2010 to August 15, 2010 (the "**Reporting Period**"). Cash on hand at August 15, 2010 is approximately $4,063,000

exclusive of a $2,400,000 funded reserve for charges created under the Initial Order (the **"CCAA Charges"**).

11. Details of the receipts and disbursements, as well as a variance analysis against the Applicant's cash flow forecast submitted in the Seventeenth Report (the **"Forecast"**), are provided below:

    (a) *Total compensation including: Salaries, wages and payroll withholdings, benefits and pension and WSIB* – Disbursements for salaries, wages and payroll withholdings, benefits and pension and WSIB of approximately $218,000 were lower than the Forecast by approximately $88,000 reflecting a reduced level of restart activity.

    (b) *Operating expenses* – The Applicant disbursed approximately $634,000 for operating expenses. This was lower than forecast by approximately $659,000 reflecting lower than expected levels of restart costs due to the deferral of expenditures.

    (c) *Utilities and fuel* – Payments for utilities or fuel during the Reporting Period were approximately $719,000 versus forecast of $2,009,000. This reflects reduced purchases as well as the impact of the Applicant's negotiation of payment terms with its main fuel supplier.

    (d) *Insurance* – Disbursements of approximately $223,000 were consistent with the forecast of $208,000.

    (e) *Restructuring costs* – Payments of restructuring costs of approximately $1,183,000 were $236,000 higher than forecast due to certain complexities encountered in relation to the finalization of the Plan and the satisfaction of the Plan Conditions.

REVISED CASH FLOW FORECAST

12. Attached as Appendix "B" is an updated cash flow forecast for the period ending September 17, 2010 (the **"Revised Forecast"**) prepared by Terrace Bay, with the assistance of the Monitor.

13. The closing cash balance at September 19, 2010 is forecast to be approximately $1,686,000. In addition, Terrace Bay maintains a funded reserve for the CCAA charges of $2,400,000. The Revised Forecast indicates that Terrace Bay should have adequate liquidity to fund its operations through September 17, 2010.

MONITOR'S RECOMMENDATION

14. The Monitor understands that a motion is being brought by Terrace Bay to extend the CCAA stay of proceedings and for other relief. The Monitor approves of the following orders being made, if this Honourable Court sees fit:

    (a) an order authorizing the extension of the Stay Period until September 17, 2010;

    (b) an order approving the extension of certain union agreements between Terrace Bay and its unions until September 15, 2010;

    (c) an order lifting the stay of proceedings to permit the making of final orders by the Ontario Assessment Review Board with respect to certain Minutes of Settlement related to proceedings involving Terrace Bay under the *Assessment Act* (Ontario); and

    (d) an order approving of the Eighteenth Report and the conduct and activities of the Monitor and its counsel as reported on therein.

All of which is respectfully submitted this 24th day of August 2010.

ERNST & YOUNG INC.
In its capacity as the Court-Appointed
Monitor of Terrace Bay Pulp Inc.

Per:

Alex Morrison
Senior Vice President

Appendix A

Terrace Bay Pulp Inc.
CCAA Cash Flows
4 Week Period Ending August 15, 2010
(CDN$000s)

Week Ended	**25-Jul-10**	**1-Aug-10**	**8-Aug-10**	**15-Aug-10**	**Actual Total**	**Forecast [1] Total**	**Variance Total**
Receipts							
Customer receipts	-	-	-	-	-	-	-
GST	-	-	-	-	-	-	-
Other receipts	-	-	-	2	2	-	2
Total receipts	-	-	-	2	2	-	2
Disbursements							
Freight & sales agent	(12)	-	-	-	(12)	-	(12)
Salaries & wages	-	(54)	-	(83)	(137)	(233)	96
Operations	(144)	(1)	(373)	(117)	(634)	(1,293)	659
Payroll withholdings	-	(19)	(22)	(0)	(41)	(50)	9
Benefits & pension	-	(9)	-	(27)	(37)	-	(37)
Bank service charges	(0)	(0)	4	-	4	-	4
WSIB	-	(3)	-	-	(3)	(23)	20
Vacation pay	-	-	-	-	-	-	-
Utilities & fuel	(19)	(671)	(26)	(4)	(719)	(2,009)	1,290
Insurance	(15)	(208)	-	-	(223)	(208)	(15)
Interest payments to secured creditors	-	-	-	-	-	-	-
Principal payments to secured creditors	-	-	-	-	-	-	-
Foreign exchange translation	-	-	-	(3)	(3)	-	(3)
Restructuring costs	(209)	-	(972)	(3)	(1,183)	(947)	(236)
Funding of reserve for CCAA charges	-	-	-	-	-	-	-
Total disbursements	(399)	(965)	(1,388)	(237)	(2,989)	(4,763)	1,774
Cash Flow	(399)	(965)	(1,388)	(235)	(2,987)	(4,763)	1,776
Bank balance, opening	7,048	6,649	5,683	4,296	7,048	7,048	-
Cash flow	(399)	(965)	(1,388)	(232)	(2,985)	(4,763)	1,778
Bank balance, closing	6,649	5,683	4,296	4,063	4,063	2,285	1,778
Funded Reserve account for CCAA charges	2,400	2,400	2,400	2,400	2,400	2,400	-

[1] From the Monitor's 17th Report

Appendix B

Terrace Bay Pulp Inc.
CCAA Cash Flows (Revised)

(CDN$000s)

Week Ended	**22-Aug-10**	**29-Aug-10**	**5-Sep-10**	**12-Sep-10**	**19-Sep-10**	Total
Receipts						
Customer receipts	-	-	-	-	-	-
GST	-	-	-	-	-	-
Other receipts	-	-	-	-	-	-
Total receipts	-	-	-	-	-	-
Disbursements						
Freight & sales agent	-	-	-	-	-	-
Salaries & wages	-	(113)	-	(70)	(93)	(276)
Operations	(25)	(71)	(60)	(60)	(60)	(276)
Payroll withholdings	-	(40)	-	-	(40)	(80)
Benefits & pension	(14)	(32)	(77)	-	(21)	(144)
WSIB	-	-	(18)	-	-	(18)
Vacation pay	-	-	-	-	-	-
Utilities & fuel	(25)	(653)	(25)	(25)	(25)	(753)
Insurance	-	-	-	-	-	-
Interest payments to secured creditors	-	-	-	-	-	-
Principal payments to secured creditors	-	-	-	-	-	-
Foreign exchange translation	-	-	-	-	-	-
Restructuring costs	(230)	(150)	(150)	(150)	(150)	(830)
Funding of reserve for CCAA charges						-
Total disbursements	(294)	(1,059)	(330)	(305)	(389)	(2,377)
Cash Flow	**(294)**	**(1,059)**	**(330)**	**(306)**	**(389)**	**(2,377)**
Bank balance, opening	4,063	3,769	2,710	2,380	2,075	4,063
Cash flow	(294)	(1,059)	(330)	(305)	(389)	(2,377)
Bank balance, closing	3,769	2,710	2,380	2,075	1,686	1,686
Funded Reserve account for CCAA charges	2,400	2,400	2,400	2,400	2,400	2,400

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TERRACE BAY PULP INC.

Applicants

Court File No. CV-09-8062-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at TORONTO

EIGHTEENTH REPORT OF ERNST & YOUNG INC.

LANG MICHENER LLP
Lawyers – Patent & Trade Mark Agents
Brookfield Place, P.O. Box 747
181 Bay Street, Suite 2500
Toronto, ON M5J 2T7

Sheryl E. Seigel (LSUC No. 21850H)
Tel: 416-307-4063
Fax: 416-365-1719
E-mail: sseigel@langmichener.ca

Alex A. Ilchenko (LSUC No. 33944Q)
Tel: 416-307-4116
Fax: 416-304-3880
E-mail: ailchenko@langmichener.ca

Solicitors for the Monitor