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.

SEVENTH REPORT OF ERNST & YOUNG INC.

DATED OCTOBER 30, 2009

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 for a stay of proceedings through April 10, 2009 (the "**Stay Period**") and on April 8, 2009, this Honourable Court ordered that the Stay Period be extended to June 30, 2009 (the "**April 8 Order**"). The Stay Period has been extended by this Honourable Court on a number of occasions, most recently pursuant to an order granted on October 16, 2009 which extended the Stay Period to November 2, 2009.

PURPOSE

2. The purpose of this Seventh Report of the Monitor (the "**Seventh Report**") is to update this Honourable Court in relation to the activities of Terrace Bay and the Monitor since the Sixth Report, including:

    (a) the ongoing activities of the Monitor and the Applicant in relation to discussions with the non-traditional term loan lender.

    (b) a proposed extension of the Stay Period until November 20, 2009.

TERMS OF REFERENCE

3. In preparing this Seventh 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 assurance in respect of such information contained in this Seventh Report. Some of the information referred to in this Seventh 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 Seventh 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.

UPDATE ON TERRACE BAY'S RESTRUCTURING PROCESS

4. As previously reported, with the onset of colder weather approaching, there are seasonal time pressures facing Terrace Bay. In order to preserve the mill facility and the operational integrity of the machinery and equipment in the mill, and to avoid the possibility of damage to chemical containment facilities, it is necessary to keep the facility heated. To the extent that there is any prospect of a sale of the mill, or obtaining value from its operating machinery and equipment, even in a liquidation, it will be necessary to heat the facility for a period of time.

5. As reported in the Fifth Report and the Sixth Report, in light of the ramifications for the Terrace Bay community should Terrace Bay permanently cease to operate, Terrace Bay has been in discussions with a possible non-traditional term loan lender, as reported in the Fifth Report and Sixth Report.

6. Terrace Bay has advised the Monitor that its discussions with the non-traditional lender have progressed since the middle of October and are continuing at the present time. It expects to be in a position to more fully update this Honourable Court regarding the status of these discussions at the hearing of the motion to extend the stay of proceedings on November 2, 2009.

7. The Applicant is seeking a short extension of the Stay Period through to November 20, 2009, to permit it to finalize discussions with the potential non-traditional term lender and more fully report to this Honourable Court regarding its proposed course of action, including other options should these discussions not be positively concluded.

RECEIPTS AND DISBURSEMENTS THROUGH OCTOBER 18, 2009

8. Attached as **Appendix "A"** to this Seventh Report is a summary of Terrace Bay's actual receipts and disbursements from October 5, 2009 to October 18, 2009 (the "**Reporting Period**"). Current cash on hand is approximately $13,377,000, plus a $2,400,000 funded reserve for CCAA charges.

REVISED CASH FLOW FORECAST

9. Attached as **Appendix "B"** is an updated cash flow forecast for the period ending December 27, 2009 (the **"Revised Forecast"**) prepared by Terrace Bay with the assistance of the Monitor. The Revised Forecast does not reflect Terrace Bay's proposed repayment of $6,000,000 of secured indebtedness of Terrace Bay to Lucky Star which was described in the Monitor's Fourth Report.

10. The closing cash balance at November 22, 2009 is forecast to be approximately $13,640,000, prior to any reserve relating to the further distribution to Lucky Star, that is the subject of a motion before this Honourable Court that has been adjourned. In addition, Terrace Bay maintains a funded reserve for the CCAA charges of $2,400,000. The forecast indicates that Terrace Bay should have adequate liquidity to fund its operations through to November 20, 2009.

MONITOR'S RECOMMENDATION

11. 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 would approve of the following orders being made by this Honourable Court if it sees fit:

    (a) an order authorizing the extension of the stay until November 20, 2009;

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

All of which is respectfully submitted this 30th day of October, 2009.

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
2 Week Period Ending October 18, 2009
(CDN$000s)

Week Ended	11-Oct-09	18-Oct-09	Actual Total	Forecast [1] Total	Variance Total
Receipts					
Customer receipts	240	154	394	964	(570)
GST	-	-	-	-	-
Other receipts	-	2	2	-	2
Total receipts	240	156	396	964	(568)
Disbursements					
Freight & sales agent	27	-	27	-	27
Salaries & wages	-	(54)	(54)	(101)	47
Operations	(28)	(6)	(34)	(60)	26
Payroll withholdings	(21)	(0)	(21)	-	(21)
Benefits & pension	(0)	(3)	(3)	-	(3)
Bank service charges	-	-	-	-	-
WSIB	-	-	-	-	-
Vacation pay	-	-	-	-	-
Utilities & fuel	(10)	(10)	(20)	(48)	28
Insurance	-	-	-	-	-
Interest payments to secured creditors	-	-	-	-	-
Principal payments to secured creditors	-	-	-	-	-
Foreign exchange translation	(14)	(9)	(23)	-	(23)
Restructuring costs	(56)	(58)	(114)	(100)	(14)
Funding of reserve for CCAA charges	-	-	-	-	-
Total disbursements	(101)	(140)	(241)	(309)	68
Cash Flow	139	16	155	655	(500)
Bank balance, opening	13,222	13,361	13,222	13,222	-
Cash flow	139	16	155	655	(500)
Bank balance, closing	13,361	13,377	13,377	13,877	(500)
Funded Reserve account for CCAA charges	2,400	2,400	2,400	2,400	-
Monitor's Trust Account	-	-	-	-	-

[1] Forecast contained in the Monitor's Sixth Report

Appendix B

Terrace Bay Pulp Inc.
CCAA Cash Flows (Revised)
(CDN$000s)

Week Ended	**25-Oct-09**	**01-Nov-09**	**08-Nov-09**	**15-Nov-09**	**22-Nov-09**	**29-Nov-09**	**06-Dec-09**	**13-Dec-09**	**20-Dec-09**	**27-Dec-09**
Receipts										
Customer receipts	247	247	247	247	247	299	-	-	-	-
GST	-	-	-	-	-	-	-	-	-	-
Other receipts	-	-	-	-	-	-	-	-	-	-
Total receipts	247	247	247	247	247	299	-	-	-	-
Disbursements										
Freight & sales agent	-	-	-	-	-	-	-	-	-	-
Salaries & wages	-	(101)	-	(101)	-	(101)	-	(101)	-	(101)
Operations	(30)	(30)	(35)	(30)	(30)	(30)	(35)	(30)	(30)	(30)
Payroll withholdings	-	-	-	-	-	-	-	-	-	-
Benefits & pension	-	-	(38)	-	-	-	(38)	-	-	-
WSIB	-	-	(18)	-	-	-	(18)	-	-	-
Vacation pay	-	-	-	-	-	-	-	-	-	-
Utilities & fuel	(24)	(24)	(24)	(24)	(24)	(24)	(24)	(24)	(24)	(24)
Insurance	-	-	(190)	-	-	-	-	(190)	-	-
Interest payments to secured creditors	-	-	-	-	-	-	-	-	-	-
Principal payments to secured creditors	-	-	-	-	-	-	-	-	-	-
Restructuring costs	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)
Funding of reserve for CCAA charges										
Total disbursements	(104)	(205)	(355)	(205)	(104)	(205)	(165)	(395)	(104)	(205)
Cash Flow	**143**	**42**	**(108)**	**42**	**143**	**94**	**(165)**	**(395)**	**(104)**	**(205)**
Bank balance, opening	13,377	13,520	13,562	13,454	13,497	13,640	13,734	13,569	13,174	13,070
Cash flow	143	42	(108)	42	143	94	(165)	(395)	(104)	(205)
Bank balance, closing	13,520	13,562	13,454	13,497	13,640	13,734	13,569	13,174	13,070	12,865
Funded Reserve account for CCAA charges	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400	2,400
Accounts receivable, opening	2,017	1,770	1,522	1,275	1,028	781	482	482	482	482
Sales	-	-	-	-	-	-	-	-	-	-
Collections of accounts receivable	(247)	(247)	(247)	(247)	(247)	(299)	-	-	-	-
Accounts receivable, closing	1,770	1,522	1,275	1,028	781	482	482	482	482	482