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.

SIXTH REPORT OF ERNST & YOUNG INC. DATED OCTOBER 13, 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**"). On June 19, 2009 this Honourable Court ordered that the Stay Period be extended to September 30, 2009 (the "**June 19 Order**") and on September 29, 2009 this Honourable Court ordered that the Stay Period be extended to October 19, 2009 (the "**September 29 Order**").

2. The Monitor filed with this Honourable Court its First Report (the "**First Report**") on April 6, 2009, its Second Report (the "**Second Report**") on May 25, 2009, its Third Report (the "**Third Report**") on June 15, 2009, its Fourth Report (the "**Fourth Report**") on September 1, 2009 and its Fifth Report (the "**Fifth Report**") on September 25, 2009. A copy of all Monitor reports that are filed and all Court Orders issued and motion material filed in this CCAA Proceeding are posted on the Monitor's website at www.ey.com/ca/terracebay.

PURPOSE

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

   (a) the ongoing activities of the Monitor and the Applicant in relation to the process authorized by the Initial Order for the solicitation of offers for a financing or a sale to a purchaser that might result in the re-start of the mill (the "**Solicitation Process**"), and in particular with respect to the status of discussions the Applicant has continued to have with a possible term lender as reported in the Fifth Report; and

   (b) a proposed extension of the Stay Period.

BACKGROUND

4. Terrace Bay operates a pulp mill in the Town of Terrace Bay, Ontario (the "**Town**"), which is located on the north shore of Lake Superior. Terrace Bay's customers include large tissue and paper producers in North America and abroad. The primary raw material for Terrace Bay's products is wood chips which, when the mill was operating, were sourced from nearby sawmills.

5. In 2006, Terrace Bay purchased the Terrace Bay pulp mill operations and other assets from its former owner, Neenah Paper Company of Canada.

6. Prior to commencing this CCAA Proceeding and due to the current difficulties in the global pulp and paper market, Terrace Bay had determined that the most prudent course of action was to idle the mill until such time as the market for its products improved to such a level that it was no longer unprofitable to run the mill. The mill was idled on February 23, 2009.

7. Buchanan Forest Products Ltd. ("**BFPL**") is an affiliated company of Terrace Bay. Terrace Bay traditionally purchased a significant portion of its pulp logs and bush chips from BFPL. Subsequent to the date of the Initial Order, a secured creditor of BFPL, The

Toronto-Dominion Bank, privately appointed Deloitte & Touché Inc. as the receiver of certain of the property and assets of BFPL.

8. Terrace Bay is a wholly owned subsidiary of Lucky Star Holdings Inc. ("**Lucky Star**").

9. Activity at the mill site is currently limited. The primary activity of Terrace Bay has been the sale and shipment of existing finished pulp inventory. At the date of the Initial Order, Terrace Bay had approximately 61,000 tons of pulp inventory on hand. This inventory was stored at the mill site and at various warehouses located throughout North America. Terrace Bay has now sold all saleable inventory.

10. The other activities of Terrace Bay relate to the preservation of the mill and related machinery and equipment and the maintenance of its water pump house. With respect to the preservation of the machinery and equipment, if the mill is not heated over the fall and winter months, the machinery and equipment of Terrace Bay would be significantly damaged due to cold weather. Such damage would both render the equipment prohibitively expensive to repair and decrease the likelihood of any buyer or financier expressing an interest in supporting Terrace Bay in the future.

11. In the materials filed in support of its CCAA application, Terrace Bay indicated that, while the mill was shut down, it would be undertaking a process to either find a buyer for the mill or to find a capital source to refinance Terrace Bay's activities. An update on the activities of Terrace Bay with regard to these efforts was included in the Fifth Report.

12. At the time this CCAA Proceeding was commenced, Terrace Bay was the dominant source of employment for residents of the Town and another nearby community, Schreiber, Ontario. In light of the importance of restarting the mill operations to the local and surrounding communities, including local native communities, sawmills and other forestry operations that are economically impacted by Terrace Bay's business, the Applicant, with the assistance of the Monitor, is seeking solutions to restart the mill and to avoid a liquidation of Terrace Bay.

TERMS OF REFERENCE

13. In preparing this Sixth 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 Sixth Report. Some of the information referred to in this Sixth 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 Sixth 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

14. As summarized in the application materials filed by the Applicant in support of the Initial Order, and in the First Report, the Second Report, the Third Report and the Fifth Report, the Applicant had three objectives with respect to the re-starting of the mill (the “**Restructuring Process**”). These included:

    (a) the commencement of a process to seek out proposals for the refinancing of the business;

    (b) the development of a plan to restructure the business to ensure continued viability of the mill; and

    (c) the commencement of a marketing process to sell the mill as a going concern.

15. Since March 11, 2009, Terrace Bay has been engaged in activities to accomplish one or more objectives of the Restructuring Process. These activities have included, among other things, updating Terrace Bay's financial projections to reflect the current status of the mill and working with the Monitor to develop information materials to send to potential financiers and/or purchasers that may be interested in supporting Terrace Bay with a view to re-starting operations at the mill.

16. Paragraph 35 of the Initial Order authorized the Monitor and Terrace Bay to conduct a process for the solicitation of offers for a financing or sale of the Property (as defined in the Initial Order) and to take such steps as are necessary to carry out the Solicitation Process in accordance with the following timetable, with such modifications, amendments or extensions of time as the Monitor and Terrace Bay deemed appropriate:

(a) preparation of a Confidential Information Memorandum (a "**CIM**") and identification of potential purchasers by March 23, 2009;

(b) dissemination of the CIM to interested parties on execution of confidentiality agreements by April 6, 2009; and

(c) receipt of expressions of interest by April 24, 2009.

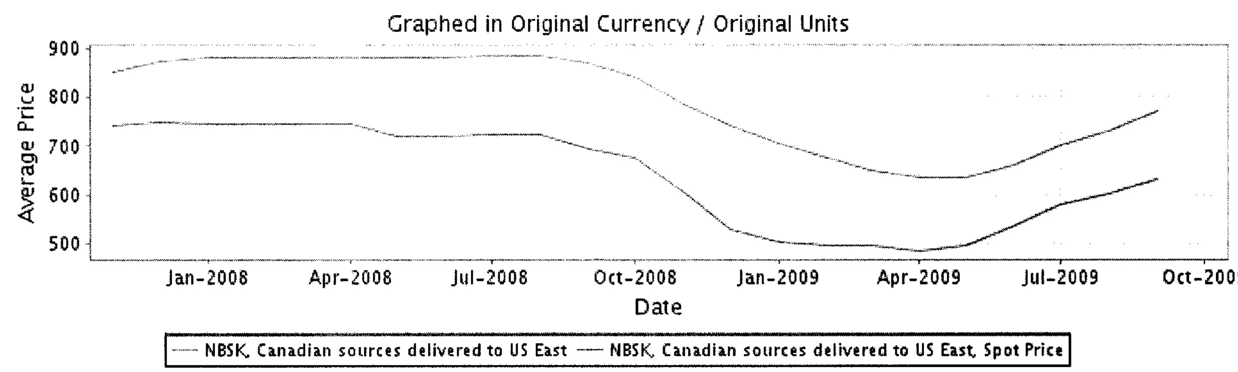
17. As reported in the Third Report and Fifth Report, the state of the forestry sector, in general, and the pulp market, in particular, has been very challenged during this CCAA Proceeding, which has made the process of raising capital or locating a purchaser very difficult.

18. As a result, no capital market solution has been secured at this stage for the necessary exit financing to support a restart of the mill and facilitate an exit from this CCAA Proceeding.

19. Management of Terrace Bay continues to be of the view that the mill is viable and financeable in more normalized and stable market conditions. Management also believes that an immediate liquidation of the mill would not be the best method of achieving value

and, accordingly, that it is not in the best interest of stakeholders to proceed immediately to liquidate Terrace Bay without exploring other options.

20. Further, the Monitor notes, as indicated in the chart below, that pulp markets have improved fairly significantly in recent weeks. These improving market conditions may now provide better options to secure the financing necessary to fund the restart of the mill operations.



Source: RISI

21. As reported in the Fifth Report, with the onset of colder weather approaching, there are seasonal time pressures facing Terrace Bay. In order to preserve the mill facility, the operational integrity of the machinery and equipment within it and 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 appears necessary to heat the facility for a period of time.

22. 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.

23. These discussions have progressed over the past two weeks, but have yet to result in an offer to provide financing. The Applicant is hopeful that securing a source of term loan financing could provide a basis for it to file a plan of arrangement or compromise under the CCAA, which would enable it to restart the mill. The Monitor has been told by the

Applicant that the potential term lender has requested additional time for discussion and exchange of information. The Applicant believes that it will be in a position to determine the results of these discussions prior to November 2, 2009, the date to which the Applicant is requesting that the Stay Period be extended.

24. Further, due to the above noted improvement in the pulp markets, recently a limited number of other parties have expressed a possible interest in Terrace Bay's facilities. At this preliminary stage, it is premature to assess whether any such party will be willing to invest in or acquire the mill.

25. The Applicant therefore is seeking a short extension of the Stay Period through to November 2, 2009, to permit it to finalize discussions with the potential non-traditional term lender. Terrace Bay and the Monitor will report back to this Honourable Court regarding the progress being made by Terrace Bay and, if satisfactory progress has not been made prior to November 2, 2009, the Applicants will advise this Honourable Court as to the proposed options and next steps. This could include options related to the closure of the mill on a permanent basis, as well as a process to attempt to find a buyer for the facility.

RECEIPTS AND DISBURSEMENTS THROUGH OCTOBER 4, 2009

26. Attached as **Appendix "A"** to this Third Report is a summary of Terrace Bay's actual receipts and disbursements from September 20, 2009 to October 4, 2009 (the "**Reporting Period**"). Current cash on hand is approximately $13,222,000, plus a $2,400,000 funded reserve for CCAA charges.

REVISED CASH FLOW FORECAST

27. Attached as **Appendix "B"** is an updated cash flow forecast for the period ending November 15, 2009 (the **"Revised Forecast"**) prepared by Terrace Bay with the assistance of the Monitor. The Revised Forecast does not reflect repayment of $6,000,000 of secured indebtedness of Terrace Bay to Lucky Star which was described in the Monitor's Fourth Report.

28. The closing cash balance at November 15, 2009 is forecast to be approximately $13,973,000, 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 15, 2009.

MONITOR'S RECOMMENDATION

29. 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 2, 2009; and

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

All of which is respectfully submitted this 13th 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
3 Week Period Ending October 4, 2009
(CDN$000s)

Week Ended	**20-Sep-09**	**27-Sep-09**	**04-Oct-09**	**Actual Total**	**Forecast[1] Total**	**Variance Total**
Receipts						
Customer receipts	275	75	12	362	1,705	(1,343)
GST	-	-	-	-	-	-
Other receipts	-	850	0	850	850	0
Total receipts	275	925	12	1,212	2,555	(1,343)
						-
Disbursements						-
Freight & sales agent	(7)	(1)	2	(7)	-	(7)
Salaries & wages	-	(52)	-	(52)	(122)	70
Operations	(17)	(30)	(4)	(51)	(75)	24
Payroll withholdings	(0)	(18)	(0)	(19)	(130)	111
Benefits & pension	(3)	(29)	(14)	(46)	(50)	4
Bank service charges	-	0	4	4	-	4
WSIB	-	-	-	-	(12)	12
Vacation pay	-	-	-	-	-	-
Utilities & fuel	(8)	(27)	(23)	(57)	(240)	183
Insurance	-	-	(188)	(188)	(188)	0
Interest payments to secured creditors	-	(2)	-	(2)	-	(2)
Principal payments to secured creditors	-	-	-	-	-	-
Foreign exchange translation	(5)	(1)	(0)	(6)	-	(6)
Restructuring costs	(97)	(37)	-	(133)	(230)	97
Funding of reserve for CCAA charges	-	-	-	-	-	-
Total disbursements	(136)	(197)	(222)	(555)	(1,047)	492
					-	-
Cash Flow	**140**	**728**	**(210)**	**657**	**1,508**	**(850)**
						-
						-
Bank balance, opening	12,565	12,704	13,432	12,565	12,565	-
Cash flow	140	728	(210)	657	1,508	(850)
Bank balance, closing	**12,704**	**13,432**	**13,222**	**13,222**	**14,072**	(850)
Funded Reserve account for CCAA charges	2,400	2,400	2,400	2,400	2,400	-
Monitor's Trust Account	850		-	-	-	-

(1) Forecast contained in the Monitor's 5th report

Appendix B

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

Week Ended	**11-Oct-09**	**18-Oct-09**	**25-Oct-09**	**01-Nov-09**	**08-Nov-09**	**15-Nov-09**	**Total**
Receipts							
Customer receipts	482	482	482	482	-	-	1,929
GST	-	-	-	-	-	-	-
Other receipts	-	-	-	-	-	-	-
Total receipts	482	482	482	482	-	-	1,929
Disbursements							
Freight & sales agent	-	-	-	-	-	-	-
Salaries & wages	-	(101)	-	(101)	-	(101)	(303)
Operations	(30)	(30)	(30)	(30)	(35)	(30)	(185)
Payroll withholdings	-	-	-	-	-	-	-
Benefits & pension	-	-	-	-	(38)	-	(38)
WSIB	-	-	-	-	(18)	-	(18)
Vacation pay	-	-	-	-	-	-	-
Utilities & fuel	(24)	(24)	(24)	(24)	(24)	(24)	(144)
Insurance	-	-	-	-	(190)	-	(190)
Interest payments to secured creditors	-	-	-	-	-	-	-
Principal payments to secured creditors	-	-	-	-	-	-	-
Restructuring costs	(50)	(50)	(50)	(50)	(50)	(50)	(300)
Funding of reserve for CCAA charges							-
Total disbursements	(104)	(205)	(104)	(205)	(355)	(205)	(1,178)
Cash Flow	**378**	**277**	**378**	**277**	**(355)**	**(205)**	**751**
Bank balance, opening	13,222	13,600	13,877	14,255	14,533	14,178	13,222
Cash flow	378	277	378	277	(355)	(205)	751
Bank balance, closing	13,600	13,877	14,255	14,533	14,178	13,973	13,973
Funded Reserve account for CCAA charges	2,400	2,400	2,400	2,400	2,400	2,400	2,400
Accounts receivable, opening	2,411	1,929	1,447	964	482	482	
Sales	-	-	-	-	-	-	
Collections of accounts receivable	(482)	(482)	(482)	(482)	-	-	
Accounts receivable, closing	1,929	1,447	964	482	482	482	