Court File No.: CV-09-824700CL

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 GRANT FOREST PRODUCTS INC., GRANT ALBERTA INC., GRANT FOREST PRODUCTS SALES INC. AND GRANT U.S. HOLDINGS GP

Applicants

REPORT OF THE PROPOSED MONITOR DATED JUNE 24, 2009

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INTRODUCTION

1. Ernst & Young Inc. ("**EYI**") understands that Grant Forest Products Inc. ("**GFPI**"), Grant Alberta Inc. ("**GAI**"), Grant Forest Products Sales Inc. ("**GFPSI**") and Grant U.S. Holdings GP ("**U.S. Holdings**") (collectively "**Grant**" or the "**Applicants**") have brought a motion before this Honourable Court for an Initial Order under the *Companies' Creditors Arrangement Act* ("**CCAA**") in order to restructure the business and affairs of the Applicants.

2. This is the first report of EYI, the Proposed Monitor in the Applicants' CCAA proceedings. EYI has consented to act as Monitor in these CCAA proceedings.

PURPOSE

3. The purpose of this report of the Proposed Monitor (the "**Report**") is to provide information to this Honourable Court on:

   i) Grant's operations and capital structure;

   ii) Grant's current liquidity position;

iii) Grant's decision to commence insolvency proceedings;

iv) an overview of Grant's 13 week cash flow forecast;

v) selected financial matters addressed in the Proposed Initial Order;

vi) restructuring alternatives and Grant's proposed marketing process; and

vii) conclusions and recommendations.

TERMS OF REFERENCE

4. In preparing this Report, EYI has been provided with and in making the comments herein relied upon, unaudited financial information, the Applicants' books and records, financial information prepared by the Applicants, and discussions with management of the Applicants. 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 Report. Some of the information referred to in this 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 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.

5. Unless otherwise stated all monetary amounts contained herein are expressed in U.S. Dollars.

6. Capitalized terms not defined in this Report are defined in the motion filed by Grant in connection with these CCAA proceedings.

7. EYI was retained by Grant on April 6, 2009, to assist it and its other professional advisors to analyse options available to refinance and restructure Grant's operations.

8. EYI does not act as auditor to Grant.

OVERVIEW

9. GFPI is a privately owned corporation carrying on an OSB manufacturing business and founded by Peter Grant Sr. A copy of the Organization Chart as attached as Exhibit "A" to the affidavit of Peter Lynch, who is the Executive Vice-President and Secretary of GFPI (the "**Lynch Affidavit**"), is reproduced as Appendix A to this Report.

10. The Applicants main product is Oriented Strand Board ("**OSB**"). OSB is an engineered, mat-formed panel product made of strands, flakes or wafers sliced from round wood logs and bonded with an exterior-type binder under heat and pressure. The finished product has similar properties to plywood and has replaced plywood in many environments, especially the North American structural panel market. The most common uses are sheathing in walls, floors, and roofs in the construction of buildings and residential housing.

11. The Applicants and certain of their subsidiaries or other related parties namely Southeast Properties LLC, Grant Newco LLC, Grant Clarendon LP, Grant Allendale LP, Grant Excluded FP, Grant U.S. Sales Inc. and Footner Forest Products Ltd. ("**Footner**") (collectively, the "**Subsidiaries**") have a total capacity to produce 3.7 billion square feet of OSB, which makes them the third largest OSB manufacturer in North America.

12. GFPI manufactures OSB in panels of varying lengths and thickness, as well as specialty products such as web stock, rim board, and oversized panels. The Applicants and the Subsidiaries have interests in three mills in Canada located at Englehart and Timmins in Ontario and High Level in Alberta. The Applicants and their Subsidiaries also have interests in the Allendale and Clarendon mills

located in South Carolina in the United States. The mills located in Englehart and Timmins in Ontario are owned by GFPI, and as such, they are included in Grant's CCAA proceedings. GFPI also has a 50% interest in a mill located at High Level in Alberta. This mill is held by Footner as bare trustee and GFPI owns 50% of the shares of Footner. The Allendale and Clarendon mills in South Carolina are owned by Grant Allendale LP and Grant Clarendon LP respectively, which are 99.9% owned by Southeast Properties LLC, but these mills are indirectly owned by GFPI. Accordingly, the following GFPI Subsidiary entities are not filing under the CCAA proceedings:

- Southeast Properties LLC;
- Grant Newco LLC;
- Grant Clarendon LP;
- Grant Allendale LP;
- Grant Excluded FP;
- Footner Forest Products Ltd; and
- Grant U.S. Sales Inc.

13. As a result of the present market conditions and the reduced demand for OSB and other wood products, only two of the OSB mills, owned directly or indirectly by GFPI located in Englehart, Ontario and Allendale, South Carolina, are presently operating. Both the mill in Timmins, Ontario and the mill in High Level, Alberta are idle. The mill in Clarendon, South Carolina is a new mill which is substantially complete but has not yet been put into production.

14. The Monitor has been advised that the Applicants continue to face significant economic challenges as a result of the continued depressed level of construction of new homes in the United States Market. As has been widely reported, the North American economy continues to contract, resulting in job losses and reduced buying power of businesses and consumers. The OSB market is significantly lower than historic norms and the continued downturn in the United

States housing market has adversely affected this Industry. These factors have resulted in a continuing challenging environment for most forest products companies in North America. There have been a large number of mill closures announced in the industry to attempt to better match production with market demand.

15. A further significant factor contributing to the challenging market conditions in the forest products sector is the rapid rise of the Canadian dollar relative to the U.S. dollar. The Applicants have significant operations in Canada but sell a majority of their products to customers in the United States.

16. The primary trade creditors of GFPI are log suppliers, log transportation providers and resin and wax suppliers. As discussed in the Lynch Affidavit, the approximate total amount owing by all the Applicants to their respective trade creditors as at May 31, 2009 is approximately US$ 0.8 million and CDN$ 3.3 million. In addition, there is approximately CDN$2.4 million owing to creditors that is accrued but not billed.

17. As of March 31, 2009, the Applicants had approximately 253 active employees including 122 unionized employees employed by GFPI. The number of active employees would have been significantly higher if all of the mills of the Applicants were in operation and these mills were running at their optimum capacity.

GRANT'S CAPITAL STRUCTURE

18. GFPI has total funded debt obligations of approximately $549 million in two levels of primary secured debt. The total debt obligations are comprised of the following facilities:

i) The Toronto-Dominion Bank ("**TD**") and a related entity, Toronto Dominion (Texas) LLC ("**TD Texas**") are agents (collectively, the "**First Lien Lenders' Agents**") for the first lien lenders (the "**First Lien Lenders**") which, as at May 31, 2009, were owed the principal amount of approximately $399 million plus accrued interest pursuant to a credit agreement dated as of October 26, 2005, as amended by an agreement dated as of March 21, 2007 (the "**First Lien Credit Agreement**").

ii) EYI understands that the Bank of New York Mellon ("**BNY**") is the agent for the second lien lenders (the "**Second Lien Lenders**") which, as at May 31, 2009, were owed the principal amount of approximately $150 million plus accrued interest pursuant to a credit agreement dated as of March 21, 2007, as amended by an agreement dated as of April 30, 2009 (the "**Second Lien Credit Agreement**").

iii) Grant is in default under both the First Lien Credit Agreement and the Second Lien Credit Agreement.

19. The Proposed Monitor has not completed any review of these credit facilities. The Proposed Monitor has based its report on the assumption that all such agreements are valid and enforceable in accordance with their terms.

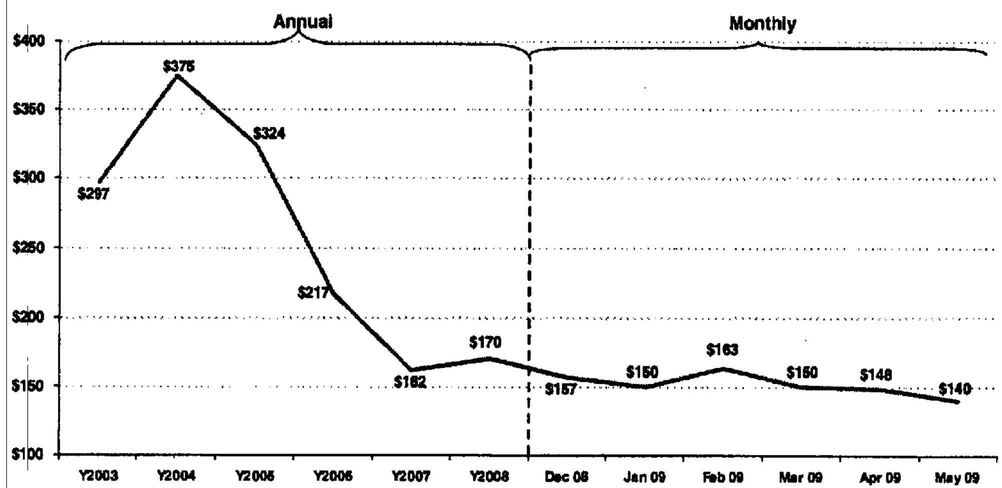
CURRENT LIQUIDITY POSITION

20. The prices for OSB have decreased significantly since 2005 and the annual consolidated sales of GFPI have accordingly also decreased substantially from approximately $506 million in 2004 to approximately $184 million in 2008. As described in the Lynch Affidavit, in its 2007 and 2008 fiscal years, GFPI incurred consolidated losses of approximately CDN$36 million and CDN$216 million, respectively. In addition, the Applicants and their Subsidiaries incurred total capital expenditures of approximately $650 million from 2005 to 2008. These were primarily related to the construction of the Allendale and Clarendon mills and the updating of the Englehart and Timmins mills.

21. In the past, the Applicants have benefited from a secure fibre supply and large scale mills which take advantage of efficiency of operations. As described earlier in this Report, there has been a significant slowdown in the construction of new homes in the U.S. Market which has a direct impact on the sale of OSB. The OSB

market is significantly lower than historic norms and the continued downturn in the U.S. housing market has adversely affected this Industry. The following graph sets out the decline in the historical prices for OSB.

22. OSB Historical Pricing from 2003 to May 2009 (US$/(msf 7/16 inch)):



Source: Random Lengths

23. In addition, the Applicants have significant debt levels as a result of the debt incurred to fund the construction of the Allendale and Clarendon mills. Construction on these mills commenced when the U.S. housing market was strong but was not completed until the OSB market decline had commenced.

24. As a result of deteriorating market conditions and a corresponding decrease in both the demand and price for all building supplies, including OSB, the losses incurred in the last two years and the cash flow deficiencies incurred due to the debt to fund the Clarendon and Allendale mills, the Applicants are experiencing financial difficulties.

DECISION TO COMMENCE INSOLVENCY PROCEEDINGS

25. As described above, the Applicants have incurred significant debt, primarily to fund the construction of the Allendale and Clarendon mills and to update the Englehart and Timmins mills. This increased debt resulted in an overleveraged debt structure that the Applicants can no longer support due to depressed OSB

market conditions.

26. Further, GFPI entered into a master aircraft lease agreement dated December 22, 1999 with GE Canada Leasing Services Company (**"GE Leasing"**) in respect of three aircraft. One of the aircraft was sold in 2008, the proceeds of which were received by GE. The remaining two aircraft were returned to GE on March 18 and March 24, 2009. These two aircraft have not been sold by GE Leasing. As of March 31, 2009, GFPI ceased making payments under the lease. GE Leasing has issued a demand for payment of approximately $31.1 million.

27. As a result of an alleged deficiency claim under the applicable master aircraft lease, GE Leasing brought an application for a bankruptcy order dated March 17, 2009 against GFPI originally returnable on April 16, 2009. GFPI filed a notice disputing the application on April 9, 2009.

28. Due to the Applicant's financial difficulties, the amount of its debt levels and the bankruptcy petition brought by GE Leasing, a stay of proceedings is essential for the continued operations of the Applicants' businesses. Such stay would provide the Applicants with the necessary time to undertake the marketing process as further described in this report. Accordingly, the Applicants believe it is necessary for them to file for CCAA protection.

OVERVIEW OF THE 13 WEEK CASH FLOW PROJECTION

29. Grant, with the assistance of the Proposed Monitor has prepared a 13 week Cash Flow Projection (the **"Cash Flow"**) for the 13 week period from June 22, 2009 to September 27, 2009. A copy of the Cash Flow is attached as Exhibit 'F' to the Lynch Affidavit. The Cash Flow is based on certain assumptions that are attached to the Cash Flow in Exhibit 'F' to the Lynch Affidavit. The Cash Flow reflects receipts and disbursements to be received or paid over the 13 week projection period in U.S. dollars.

30. Grant's cash position at the commencement of the CCAA proceedings is estimated to be approximately $27 million (including restricted cash of approximately $400,000).

31. During the 13 week period, Grant estimates that the Applicants will not need to transfer funds to its U.S. operations, however, it is anticipated that $0.8 million will be required to fund Footner. Any transfers to these affiliates are necessary to preserve Grant's interests in the value of these operations. The Applicants believe that it is essential that Footner receives these funds.

32. The Cash Flow forecast projects that the Applicants will have sufficient liquidity to operate during the CCAA proceedings.

SELECTED FINANCIAL MATTERS ADDRESSED IN THE PROPOSED INITIAL ORDER

33. The proposed Initial Order provides for the engagement of a Chief Restructuring Advisor, and also sets out a number of charges and thresholds relating to asset sales, etc. including:

- *Chief Restructuring Advisor*

34. The proposed Initial Order contemplates the continuation of the engagement of Stonecrest Capital Inc. ("**Stonecrest**") as Chief Restructuring Advisor (the "**CRA**") with services to be provided by Hap Stephen and Sandra Rosch. The proposed Initial Order further contemplates that the CRA shall have and may exercise and perform the powers, responsibilities and duties described in an engagement letter between Stonecrest and GFPI, together with such other powers, responsibilities and duties as may be agreed upon by the CRA and GFPI and approved by the Monitor or this Honourable Court.

- *Administration Charge*

35. The Administration Charge as described in the proposed Initial Order provides for an amount of CDN$2.0 million in favour of the Monitor, counsel to the Monitor, counsel to GFPI's board of directors, the CRA and the Applicants' counsel as security for the professional fees and disbursements incurred both before and after the making of the Initial Order in respect of these proceedings. The Proposed Monitor believes that the charge is required and reasonable under the circumstances.

- *Investment Offering Advisor Charge*

36. The Investment Offering Advisor Charge as described in the proposed Initial Order provides for an amount of CDN$200,000 in favour of an advisor who will assist with the proposed marketing process (the "**Investment Offering Advisor**"), to secure its fees and recoverable disbursements as set out in the Investment Offering Advisor Engagement Letter.

37. It is contemplated that the Investment Offering Advisory Charge shall rank *pari passu* with the Administration Charge.

- *Key Employee Retention Plan ("KERP") Charge*

38. The KERP Charge as described in the proposed Initial Order provides for a maximum amount of CDN$1,134,000 in favour of Peter Lynch as security for all amounts owing to him pursuant to an agreement dated December 19, 2008 and amended by a further agreement dated April 1, 2009, as described in the Lynch Affidavit (the "**KERP Agreement**"), both before and after the date of the proposed Initial Order.

39. As described previously, Peter Lynch is a senior executive of GFPI. Peter is not part of the Grant family and has been involved with Grant since its inception.

40. The Monitor has been informed that the First Lien Lenders recognise the importance of Peter Lynch's role in the restructuring process.

41. It is contemplated that the KERP Charge will stand second in priority, after the Administration Charge and the Investment Offering Advisor Charge, as set out in the proposed Initial Order.

- *Directors' Charge*

42. The Directors' Charge as described in the proposed Initial Order, provides for an amount of CDN$3.0 million to indemnify the directors and officers of Grant from all claims, costs, charges and expenses if the Applicants fail to pay certain amounts after the date of the Initial Order. Specifically, if the directors fail to pay amounts in respect of employee or former employee entitlements, statutory deemed trust amounts in favour of the Crown which are required to be deducted from employees' wages, including amounts in respect of employment insurance, Canada Pension Plan, Quebec Pension Plan and income taxes; and any amount payable to the Crown or any taxation authority in respect of municipal realty, municipal business or other taxes, which are entitled at law to be paid in priority to claims of secured creditors. The amount of the Directors' Charge was estimated by Grant taking into consideration the amount of its hourly and salaried payroll, vacation pay and sales and service taxes.

43. It is contemplated that the Directors' Charge will rank *pari passu* with the KERP Charge, after the Administration Charge and the Investment Offering Advisor Charge, as set out in the proposed Initial Order.

- *Sale of Assets*

44. The thresholds established in the proposed Initial Order for Grant's rights to dispose of redundant or non material assets provided that the price not exceed CDN$500,000 in any one transaction or CDN$2 million in aggregate, was established in relation to the size of Grant's operations and value of its assets in order to facilitate the orderly restructuring of the enterprise without adding undue

administrative burden that would not add value to the process. In the Proposed Monitor's view, these thresholds are appropriate given the size of Grant's operations.

- *Creditor Notification*

45. The proposed Initial Order contemplates that the Applicants shall, within ten business days of the date of entry of the Initial Order, send a copy of the Initial Order to their known creditors, other than employees and creditors to the Applicants owed less than CDN$1,000. The Proposed Monitor is therefore relieved of its obligation under Section 11(5) of the CCAA to provide similar notice, but will supervise this process.

RESTRUCTURING ALTERNATIVES AND GRANT'S PROPOSED MARKETING PROCESS

46. At this preliminary stage, it is not possible to present a comprehensive restructuring strategy as Grant and its advisors will need to continue discussions that have been ongoing with its First Lien Lenders and Second Lien Lenders as well as certain of its other creditor stakeholders. The CCAA proceedings will contribute a stable environment to enable Grant to operate its business while these discussions occur.

47. Grant has a significant market presence in the OSB market, and owns a number of large, low cost mills which should provide a number of options to restructure the business.

48. Grant along with its advisors, including an Investment Offering Advisor (once one has been retained), is proposing to conduct a marketing process as set out in the proposed Initial Order. A detailed protocol with respect to the marketing process (the "**Investment Offering Protocol**") is set out in Appendix A to the proposed Initial Order. The Proposed Monitor has reviewed the Investment Offering Protocol and agrees with the marketing process set out therein.

49. The Investment Offering Protocol requires the Monitor to facilitate and oversee the marketing process undertaken by Grant and its advisors in accordance with the Investment Offering Protocol.

50. The Investment Offering Protocol also provides that the Monitor may provide periodic updates to the stakeholders who have executed confidentiality agreements and also that the Monitor jointly with Grant will agree on a preliminary potential interested party list with input from the Investment Offering Advisor and nominations provided by the stakeholders.

CONCLUSIONS AND RECOMMENDATION

51. The Proposed Monitor believes that it is appropriate that the Applicants be granted the benefit of protection under the CCAA, so they are able to stabilize their operations while it undertakes the marketing process as set out in the Investment Offering Protocol and continues discussions with its key stakeholders regarding a restructuring under CCAA supervision in a manner that is in the best interest of its stakeholders.

52. Further to EYI's review of the proposed Initial Order, EYI supports the thresholds in the proposed Initial Order, including:

i) an Administration Charge of CDN$2.0 million;

ii) a KERP Charge of CDN$1.134 million;

iii) a Directors' Charge of CDN$3.0 million;

iv) asset sales of CDN$0.5 million or CDN$2.0 million in aggregate; and

v) Notices to creditors (excluding employees) with outstanding balances of CDN$1,000 or more.

53. The Proposed Monitor has reviewed the Applicants' proposed Investment Offering Protocol and the Proposed Monitor agrees with such process.

All of which is respectfully submitted this 24th day of June, 2009.

ERNST & YOUNG INC.
in its capacity as the Proposed Monitor of
Grant Forest Products Inc.,
Grant Alberta Inc.,
Grant Forest Products Sales Inc., and
Grant U.S. Holdings G.P.

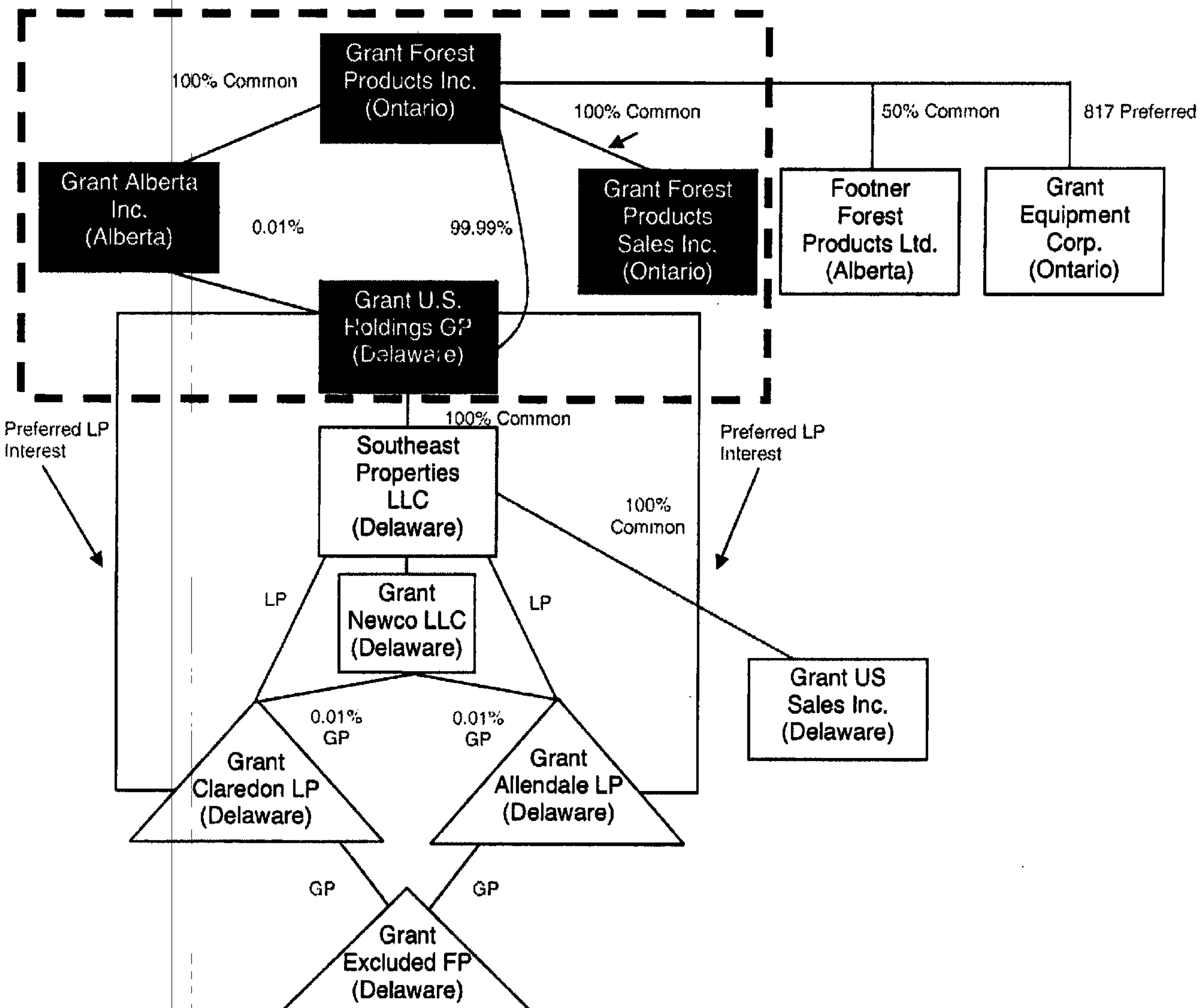
Per:

Alex Morrison
Senior Vice President

APPENDIX A

Organizational Structure of the Applicants and the Subsidiaries

June 1, 2009



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