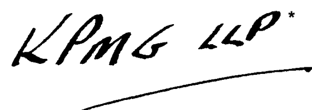
Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Tembec Inc. as at September 26, 2009 and September 27, 2008, the consolidated statements of operations and deficit and cash flows for the year ended September 26, 2009, and the seven-month period ended September 27, 2008, and of the Predecessor for the five-month period ended February 29, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian Generally Accepted Auditing Standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 26, 2009 and September 27, 2008, and the results of its operations and its cash flows for the year ended September 26, 2009, and the seven-month period ended September 27, 2008, and of the Predecessor for the five-month period ended February 29, 2008, in accordance with Canadian Generally Accepted Accounting Principles.



Chartered Accountants

Montréal, Canada
November 6, 2009

*CA Auditor permit nº 8821

CONSOLIDATED BALANCE SHEETS

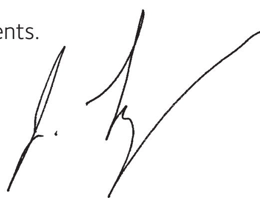
(in millions of dollars)

	Sept. 26, 2009	Sept. 27, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 105	$ 113
Derivative financial instruments (note 18)	–	1
Accounts receivable (notes 8 and 18)	283	371
Inventories (notes 4 and 8)	319	414
Prepaid expenses	13	19
Current assets of discontinued operations (note 3)	–	2
	720	920
Investments	15	9
Fixed assets (note 6)	626	668
Other assets (note 7)	5	22
	$ 1,366	$ 1,619
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Bank indebtedness	$ –	$ 1
Operating bank loans (note 8)	118	49
Accounts payable and accrued charges	275	375
Interest payable	3	3
Current portion of long-term debt (note 9)	19	18
Current liabilities related to discontinued operations (note 3)	3	3
	418	449
Long-term debt (note 9)	383	378
Other long-term liabilities and credits (note 10)	219	229
Future income taxes (note 16)	–	2
Minority interest	–	1
Non-current liabilities related to discontinued operations (note 3)	33	38
Shareholders' equity:		
Share capital (note 11)	570	570
Contributed surplus (note 3)	5	–
Deficit	(262)	(48)
	313	522
	$ 1,366	$ 1,619

Guarantees, commitments and contingencies (note 12)
Subsequent event (note 20)
See accompanying notes to consolidated financial statements.

On behalf of the Board:

James V. Continenza
Chairman of the Board



James M. Lopez
President and Chief Executive Officer

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

Year ended September 26, 2009,
seven-month period ended September 27, 2008 and five-month period ended February 29, 2008
(in millions of dollars, unless otherwise noted)

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Sales	**$ 1,786**	$ 1,426	$ 950
Freight and sales deductions	**224**	181	111
Lumber export taxes (note 12)	**4**	7	4
Cost of sales	**1,578**	1,139	804
Selling, general and administrative	**88**	61	48
Depreciation and amortization (note 13)	**73**	51	72
Restructuring and asset impairment charges (credits) (note 14)	**3**	(3)	–
Gain on land sales and other (note 14)	**(6)**	(2)	(20)
Operating loss from continuing operations	**(178)**	(8)	(69)
Interest, foreign exchange and other (note 15)	**22**	13	32
Exchange loss (gain) on long-term debt	**21**	15	(9)
Loss from continuing operations before income taxes and minority interest	**(221)**	(36)	(92)
Income tax expense (recovery) (note 16)	**(1)**	5	6
Minority interest	**(1)**	–	–
Net loss from continuing operations	**(219)**	(41)	(98)
Earnings (loss) from discontinued operations (note 3)	**5**	(7)	(4)
Net loss and comprehensive loss	**(214)**	(48)	(102)
Deficit, beginning of year	**(48)**	–	(271)
	(262)	(48)	(373)
Adjustment for fresh start accounting	**–**	–	373
Deficit, end of year	**$ (262)**	$ (48)	$ –
Basic and diluted loss per share from continuing operations (note 11)	**$ (2.19)**	$ (0.41)	$ (1.14)
Basic and diluted earnings (loss) per share from discontinued operations (note 3)	**$ 0.05**	$ (0.07)	$ (0.05)
Basic and diluted loss per share (note 11)	**$ (2.14)**	$ (0.48)	$ (1.19)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended September 26, 2009,
seven-month period ended September 27, 2008 and five-month period ended February 29, 2008
(in millions of dollars)

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Cash flows from operating activities:			
Net loss	**$ (214)**	$ (48)	$ (102)
Adjustments for:			
Depreciation and amortization (note 13)	**73**	51	72
Unrealized foreign exchange and others	**(4)**	(2)	(2)
Exchange loss (gain) on long-term debt	**21**	15	(9)
Future income taxes (notes 3 and 16)	**3**	1	6
Investment tax credits and income tax refunds	**17**	(1)	(7)
Restructuring and asset impairment charges (credits) (note 14)	**3**	(3)	–
Gain on land sales and other (note 14)	**(6)**	(2)	(20)
Gain on sale of mill site – discontinued operations (note 3)	**(16)**	–	–
Differences between cash contributions and pension expense	**(9)**	(11)	(8)
Other	**–**	4	5
	(132)	4	(65)
Changes in non-cash working capital:			
Accounts receivable	**82**	(35)	22
Inventories	**86**	35	(54)
Prepaid expenses	**6**	–	(4)
Accounts payable and accrued charges	**(103)**	29	(26)
	71	29	(62)
	(61)	33	(127)
Cash flows from investing activities:			
Reduced participation in joint ventures	**18**	6	(5)
Additions to fixed assets	**(42)**	(42)	(23)
Proceeds from disposal of fixed assets	**–**	2	–
Proceeds on sale of mill site – discontinued operations (note 3)	**7**	–	–
Proceeds on land sales and other	**1**	–	17
Decrease in investments	**4**	22	2
Other	**1**	2	1
	(11)	(10)	(8)
Cash flows from financing activities:			
Change in operating bank loans	**69**	(13)	(27)
Increase in long-term debt	**9**	5	300
Repayments of long-term debt	**(20)**	(9)	(5)
Change in other long-term liabilities	**–**	(2)	(3)
Recapitalization fees and other	**5**	–	(36)
	63	(19)	229
	(9)	4	94
Foreign exchange loss (gain) on cash and cash equivalents held in foreign currencies	**2**	(1)	1
Net increase (decrease) in cash and cash equivalents	**(7)**	3	95
Cash and cash equivalents, net of bank indebtedness, beginning of period	**112**	109	14
Cash and cash equivalents, net of bank indebtedness, end of period	**$ 105**	$ 112	$ 109

Interest paid in 2009 totalled $37 million (seven months ended September 2008 – $21 million; five months ended February 2008 – $48 million) and income taxes recovered amounted to $16 million (seven months ended September 2008 – $1 million; five months ended February 2008 – $1 million).

See accompanying notes to consolidated financial statements.

CONSOLIDATED BUSINESS SEGMENT INFORMATION

(in millions of dollars)

	The Company Year ended September 26, 2009					
	Forest Products	**Pulp**	**Paper**	**Chemicals**	**Corporate and other**	**Consolidated**
Sales:						
External	$ 304	$ 932	$ 452	$ 98	$ –	$ 1,786
Internal	103	78	–	–	4	185
	407	1,010	452	98	4	1,971
Earnings (loss) before the following:	(67)	(61)	27	10	(17)	(108)
Depreciation and amortization (note 13)	24	44	3	2	–	73
Other items (note 14)	(3)	(4)	2	1	1	(3)
Operating earnings (loss) from continuing operations	(88)	(101)	22	7	(18)	(178)
Net fixed asset additions:						
Gross fixed asset additions	6	31	4	1	–	42
Proceeds from disposal	–	–	–	–	–	–
	6	31	4	1	–	42
Identifiable assets – excluding cash and cash equivalents	251	833	126	38	13	1,261
Cash and cash equivalents						105
Total assets						$ 1,366

	The Company Seven months ended September 27, 2008					
	Forest Products	Pulp	Paper	Chemicals	Corporate and other	Consolidated
Sales:						
External	$ 276	$ 810	$ 270	$ 70	$ –	$ 1,426
Internal	86	36	–	3	1	126
	362	846	270	73	1	1,552
Earnings (loss) before the following:	(29)	68	9	5	(15)	38
Depreciation and amortization (note 13)	16	31	2	2	–	51
Other items (note 14)	(3)	–	–	–	(2)	(5)
Operating earnings (loss) from continuing operations	(42)	37	7	3	(13)	(8)
Net fixed asset additions:						
Gross fixed asset additions	7	31	3	1	–	42
Proceeds from disposal	(1)	(1)	–	–	–	(2)
	6	30	3	1	–	40
Identifiable assets – excluding cash and cash equivalents	296	979	170	50	11	1,506
Cash and cash equivalents						113
Total assets						$ 1,619

CONSOLIDATED BUSINESS SEGMENT INFORMATION (continued)
(in millions of dollars)

	The Predecessor Five months ended February 29, 2008					
	Forest Products	Pulp	Paper	Chemicals	Corporate and other	Consolidated
Sales:						
External	$ 196	$ 533	$ 165	$ 56	$ –	$ 950
Internal	59	31	–	1	2	93
	255	564	165	57	2	1,043
Earnings (loss) before the following:	(43)	50	(18)	4	(10)	(17)
Depreciation and amortization (note 13)	23	31	15	1	2	72
Other items (note 14)	(18)	(3)	(1)	–	2	(20)
Operating earnings (loss) from continuing operations	(48)	22	(32)	3	(14)	(69)
Net fixed asset additions:						
Gross fixed asset additions	2	19	2	1	(1)	23
Proceeds from disposal	–	–	–	–	–	–
	2	19	2	1	(1)	23

CONSOLIDATED GEOGRAPHIC SEGMENT INFORMATION

Year ended September 26, 2009,
seven-month period ended September 27, 2008, and five-month period ended February 29, 2008
(in millions of dollars)

					The Company Year ended September 26, 2009
	Forest Products	**Pulp**	**Paper**	**Chemicals**	**Consolidated**
Sales (by final destination):					
Canada	**$ 190**	**$ 19**	**$ 75**	**$ 42**	**$ 326**
United States	**110**	**176**	**349**	**32**	**667**
Pacific Rim and India	**4**	**278**	**4**	**2**	**288**
United Kingdom, Europe and other	**–**	**459**	**24**	**22**	**505**
	$ 304	**$ 932**	**$ 452**	**$ 98**	**$ 1,786**

					The Company Seven months ended September 27, 2008
	Forest Products	Pulp	Paper	Chemicals	Consolidated
Sales (by final destination):					
Canada	$ 142	$ 23	$ 40	$ 31	$ 236
United States	133	113	209	23	478
Pacific Rim and India	–	282	6	2	290
United Kingdom, Europe and other	1	392	15	14	422
	$ 276	$ 810	$ 270	$ 70	$ 1,426

					The Predecessor Five months ended February 29, 2008
	Forest Products	Pulp	Paper	Chemicals	Consolidated
Sales (by final destination):					
Canada	$ 108	$ 15	$ 27	$ 28	$ 178
United States	87	78	128	17	310
Pacific Rim and India	–	171	–	1	172
United Kingdom, Europe and other	1	269	10	10	290
	$ 196	$ 533	$ 165	$ 56	$ 950

	Sept. 26, 2009	Sept. 27, 2008
Fixed assets:		
Canada	**$ 448**	$ 492
United States	**2**	2
United Kingdom, Europe and other	**176**	174
	$ 626	$ 668

1. BASIS OF PRESENTATION

Current economic conditions combined with difficult market fundamentals for certain of the Company's principal products, namely lumber and newsprint, are negatively impacting cash flows from operations. Should these conditions deteriorate further or persist for an extended period of time, there is a risk that the Company's liquidity will decline to levels where it may not be able to discharge all its obligations as they become due. Management is monitoring the situation very closely and believes that effective management of its operations and financial resources will allow the Company to continue to meet all of its obligations as they become due. Accordingly, these consolidated financial statements have been prepared on the going concern basis.

PLAN OF ARRANGEMENT

On February 29, 2008, the Predecessor implemented the plan of arrangement approved by the Ontario Superior Court having the following key elements:

- Conversion of US $1.2 billion of the Predecessor's senior unsecured debt into equity of the Company;
- Noteholders received 88% of the equity of the Company in full settlement of their notes;
- An additional 7% of the equity of the Company was allocated to noteholders who backstopped the new loan described below;
- Existing shareholders received 5% of the equity of the Company and "cashless" warrants to acquire additional shares; and
- A new four-year term loan of US $300 million was obtained to provide additional liquidity.

The Company's balance sheet as at February 29, 2008, was prepared under the provisions of the Canadian Institute of Chartered Accountants (CICA) Handbook Section (HB) 1625, *Comprehensive Revaluation of Assets and Liabilities* (fresh start accounting). Under fresh start accounting, the Company was required to determine its enterprise value. The enterprise value of $570 million was determined based on the fair value of the unsecured debt converted into equity and of the issuance of common shares and cashless warrants to the shareholders of the Predecessor. In conjunction with the Predecessor's reorganization proceedings, independent third party valuations were also obtained to assist with the allocation of the fair value to the individual assets and liabilities.

The Predecessor's financial information is presented to provide additional information for the reader. In reviewing the Predecessor's financial information, readers are reminded that they do not reflect the effects of the financial reorganization. Certain amounts presented in the Predecessor's financial information have been reclassified to conform with the presentation adopted by the Company. Detailed information on the plan of arrangement, the impact of adjustments and fresh start accounting is available in the annual audited financial statements as at September 27, 2008.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP), which require management to make assumptions and estimates that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

BASIS OF VALUATION

With the application of fresh start accounting on February 29, 2008, by the Company, all assets and liabilities were reported at fair values as further described in note 1. Goodwill is not recorded under GAAP applicable to fresh start accounting. In addition, a review of the estimated remaining useful life of certain fixed assets was also undertaken. The review indicated that the estimated useful life of several Pulp segment fixed assets was longer than originally anticipated and periodic future depreciation expense should be reduced.

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and the Predecessor, Tembec Inc. (the "Corporation"), and all its subsidiaries and joint ventures (collectively "Tembec" or the "Company"). Investments over which the Corporation has effective control are fully consolidated. Investments over which the Corporation exercises significant influence are accounted for by the equity method. The Corporation's interest in joint ventures is accounted for by the proportionate consolidation method.

BUSINESS OF THE COMPANY

The Company operates an integrated forest products business. The performance of each segment is evaluated by the management of the Company against short-term and long-term financial objectives, as well as environmental, safety and other key criteria. The Forest Products segment consists primarily of forest and sawmill operations, which produce lumber and building materials. The Pulp segment includes the manufacturing and marketing activities of a number of different types of pulps. The Paper segment consists primarily of production and sales of newsprint and bleached board. The Chemicals segment consists primarily of the transformation and sale of resins and pulp by-products. Intersegment transfers of wood chips, pulp and other services are recorded at transfer prices agreed to by the parties, which are intended to approximate fair value. The accounting policies used in these business segments are the same as those described below.

CHANGE IN ACCOUNTING POLICY

In January 2009, the CICA Emerging Issues Committee issued Abstract 173, *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, effective for interim and annual financial statements for the periods ended after January 19, 2009. This interpretation must be applied retrospectively without restatement of prior periods. This Abstract clarifies that the Company must consider its own credit risk and the credit risk of a counterparty in the determination of the fair value of derivative instruments. This Abstract did not have a material impact on the Company's financial statements.

USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Significant areas requiring the use of management estimates are: useful lives of plant and equipment, value of investments, impairment of long-lived assets, employee future benefits, income taxes, asset retirement obligations and environmental accruals. Actual results could differ from those estimates.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE

The Company recognizes revenue when persuasive evidence of an arrangement exists, goods have been delivered, there are no uncertainties surrounding product acceptance, the related revenue is fixed and determinable and collection is reasonably assured. Revenues are recorded using the gross method.

FINANCIAL INSTRUMENTS

The Company classifies its cash and cash equivalents as held-for-trading. Accounts receivable are classified as loans and receivables. The Company's investments consist mainly of long-term advances and loans receivable which are classified as loans and receivables. Bank indebtedness, operating bank loans, accounts payable and accrued charges, long-term debt, including interest payable, are classified as other liabilities, all of which are measured at amortized cost. The Company has elected to measure all derivatives and embedded derivatives at fair value and the Company has maintained its policy not to use hedge accounting.

Transaction costs incurred upon the issuance of debt instruments or modification of a financial liability are now deducted from the financial liability and are amortized using the effective interest method over the expected life of the related liability.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents, including cash on hand, demand deposits, banker's acceptances and commercial paper with maturities of three months or less from date of purchase, are recorded at cost, which approximates fair value.

INVENTORIES

Finished goods and work in process are valued at the lower of cost, determined on an average cost basis, and net realizable value. Wood chips, logs and other raw materials are valued at the lower of cost or net realizable value. For all raw materials to be used in the production of finished goods, net realizable value is determined on an as converted to finished goods basis. Operating, maintenance and spare parts inventories are valued at lower of cost and net realizable value.

INVESTMENTS

Investments in affiliated companies in which Tembec has no significant influence are carried at cost. Investments over which the Company exercises significant influence are accounted for by the equity method.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FIXED ASSETS AND GOVERNMENT ASSISTANCE

Fixed assets are recorded at cost after deducting investment tax credits and government assistance. Depreciation and amortization are provided over their estimated useful lives, generally on a straight-line basis, as follows:

Assets	Period
Buildings, pulp and newsprint production equipment	20 - 30 years
Sawmill production equipment	10 - 15 years
Paperboard mill production equipment	25 - 30 years

Certain forest access roads and timber holdings are depreciated in relation to the volume of wood cut, and certain machinery and equipment are depreciated using units of production method. Repairs and maintenance as well as planned shutdown maintenance are charged to expense as incurred.

Capitalized interest is based on the average cost of construction of major projects in progress during the year, using interest rates actually paid on long-term debt.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the assets may not be recoverable, as measured by comparing their net book value to the estimated undiscounted future cash flows generated by their use. Impaired assets are recorded at fair value, determined principally by using discounted future cash flows expected from their use and eventual disposition.

OTHER ASSETS

Timber rights are amortized on a straight-line basis over a period not exceeding 40 years.

Assets held for resale are valued at the lower of cost and fair value less cost to sell.

ENVIRONMENTAL COSTS

The Company is subject to environmental laws and regulations enacted by federal, provincial, state and local authorities. Environmental expenditures that will benefit the Company in future years are recorded at cost and capitalized as part of fixed assets. Depreciation is charged to income over the estimated future benefit period of the assets. Environmental expenditures, that are not expected to provide a benefit to the Company in future periods, are accrued and expensed to earnings, on a site-by-site basis, when a requirement to remedy an environmental exposure is probable and cost can be reasonably estimated.

ASSET RETIREMENT OBLIGATIONS

Asset retirement obligations are recognized, at fair value, in the period in which the Company incurs a legal obligation associated with the retirement of an asset. The associated costs are capitalized as part of the carrying value of the related asset and depreciated over its remaining useful life. The liability is accreted using a credit adjusted risk-free interest rate.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EMPLOYEE FUTURE BENEFITS

Employee future benefits include pension plans and other employee future benefit plans. Other employee future benefit plans include post-retirement life insurance programs, health care and dental care benefits as well as certain post-employment benefits provided to disabled employees. Registered pension plans are funded in accordance with applicable legislation and their assets are held by an independent trustee. The obligations of non-registered pension plans and other employee future benefit plans are funded by the Company as they become due.

The Company accrues the cost of defined benefit plans as determined by independent actuaries based on assumptions determined by the Company. The net periodic benefit cost includes:

- The cost of employee future benefits provided in exchange for employees' services rendered during the year;
- The interest cost on employee future benefit obligations;
- The expected return on pension fund assets based on the fair value of plan assets;
- Gains or losses on settlements or curtailments where, when the restructuring of a defined benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement;
- The straight-line amortization of past service costs and plan amendments over the average remaining service period to full eligibility of the active employee group covered by the defined benefit plans or the average remaining lifetime of those entitled to benefits for plans covering only inactive participants; and
- The amortization of cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the accrued benefit obligation or fair value of plan assets at the beginning of year, over the average remaining service period of the active employee group covered by the defined benefit plans or the average remaining lifetime of those entitled to benefits for plans covering only inactive participants.

The employee future benefit obligations are determined in accordance with the projected benefit method prorated on services.

TRANSLATION OF FOREIGN CURRENCIES

Monetary assets and liabilities of domestic and integrated foreign operations denominated in foreign currencies are translated at year-end exchange rates. Non-monetary assets and liabilities of integrated foreign operations are translated at the historical rate relevant for the particular asset or liability. The exchange gains or losses resulting from the translations are included in "Interest, foreign exchange and other" expenses. Revenues and expenses are translated at prevailing exchange rates during the year.

INCOME TAXES

The Company accounts for income taxes using the asset and liability method. Under this method, future income tax assets and liabilities are determined based on the temporary differences between the accounting basis and the tax basis of assets and liabilities. These temporary differences are measured using the enacted or substantially enacted tax rates and laws expected to apply when these differences reverse. Future tax benefits are recognized to the extent that realization of such benefits is considered more likely than not. The effect on future tax assets and liabilities of a change in income tax rates is recognized in earnings in the period that includes the substantive enactment date.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVESTMENT TAX CREDITS

Investment tax credits related to research and development are recognized in earnings as a reduction of such expenses when the Company has made the qualifying expenditures and there is reasonable assurance that the credits will be realized.

STOCK-BASED COMPENSATION PLANS

The Company uses the fair value based approach of accounting for stock options and performance share units (PSUs) granted to its employees and directors share units (DSUs) granted to its directors. Any consideration paid by plan participants in the exercise of share options or purchase of stock is credited to capital stock. The contributed surplus component of stock-based compensation is transferred to capital stock upon the issuance of common shares. PSUs are amortized over their vesting periods and remeasured at each reporting period, until settlement, using the quoted market value. DSUs are accounted for in compensation expense at the time of issuance. Their value is remeasured at each reporting period, using the quoted market value.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company manages, from time to time, its foreign exchange exposure on anticipated net cash inflows, principally US dollars and euros, through the use of options and forward contracts.

The Company may, from time to time, manage its exposure to commodity price risk associated with sales of lumber, pulp and newsprint through the use of cash-settled hedge (swap) contracts. The Company does not hold or issue derivative financial instruments for trading or speculative purposes.

The Company does not currently apply hedge accounting for these derivative financial instruments. These are measured at fair value, with changes in fair value recognized in income.

EMISSION RIGHTS AND TRADING

The Company is participating in European Emissions Trading, in which it has been allocated allowances to emit a fixed tonnage of carbon dioxide in a fixed period of time.

Emission allowances are initially recorded as intangible assets with a credit to deferred income. They are recognized when the Company is able to exercise control and are measured at fair value at the date of initial recognition. The balances are netted for reporting purposes.

The liability to deliver allowances is recognized based on actual emissions and will be settled using allowances on hand measured at their carrying amount, with any excess emissions being measured at the market value of the allowances at period-end. The resulting charge to cost of sales will be offset by the income from the original grant of the rights, together with income from the release or sale of surplus rights.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FUTURE CHANGES IN ACCOUNTING POLICIES

In January 2009, the CICA issued three new accounting standards: Section 1582, *Business Combinations*, Section 1601, *Consolidated Financial Statements*, and Section 1602, *Non-controlling Interest*.

Section 1582 replaces former Section 1581 and establishes standards for the accounting of a business combination and is mostly aligned with International Financial Reporting Standards 3 (IFRS 3), *Business Combinations*. This section specifies an expanded definition of a business that most assets acquired and liabilities assumed will be measured at fair value and that acquisition costs will be recognized as expenses.

Sections 1601 and 1602 together replace former Section 1600, *Consolidated Financial Statements*. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602, which converges with the requirements of International Accounting Standard 27 (IAS 27), *Consolidated and Separate Financial Statements*, establishes standards for accounting of a non-controlling interest resulting from a business acquisition recognized as a distinct component of shareholders' equity. Net income will present the allocation between the controlling and non-controlling interest.

For the Company, these three standards will become effective for business combinations for which the acquisition date is on or after September 25, 2011. As Section 1582 is applicable only to future business combinations, the Company does not expect these new standards to have a material impact on the Company's consolidated financial statements prior to such acquisitions.

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

In 2005, the Accounting Standards Board of Canada (AcSB) announced that accounting standards in Canada are to converge with International Financial Reporting Standards (IFRS). On February 13, 2008, the AcSB confirmed that publicly accountable enterprises would be required to apply, and report in accordance with IRFS, in full and without modification, effective in fiscal years beginning on or after January 1, 2011, which, in the case of the Company, represents interim and fiscal year-end period beginning on September 25, 2011 (the "Changeover" date). In the Company's reporting in those periods following the Changeover date, the Company will be required to present comparative data for equivalent periods in the previous fiscal year, making September 26, 2010, the "Transition" date for the Company.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

IFRS uses a conceptual framework similar to Canadian GAAP, but presents significant differences on certain recognition, measurement and disclosure principles. In the period leading up to the Changeover, the AcSB will continue to issue accounting standards that are better aligned with IFRS, as illustrated by Section 3031, *Inventories*, applicable for the Company as of February 29, 2008, and Section 3064, *Goodwill and Intangible Assets*, applicable for the Company as of September 27, 2009, as they respectively relate to IAS 2, *Inventories*, and IAS 38, *Intangible Assets*, thus mitigating the impact of conversion to IFRS. Further, the International Accounting Standards Board (IASB) will also continue to issue new, or amend existing accounting standards during the conversion period, and, as a result, the final impact on the Company's consolidated financial statements of applying IFRS in full will only be entirely measurable once all applicable IFRS standards at the final Changeover date are known.

The Company has developed a plan to convert its consolidated financial statements to IFRS. The Company has also set up an IFRS dedicated team. The Company is monitoring the impact of the transition on its business practices, systems and internal controls over financial reporting. A detailed analysis of the differences between IFRS and the Company's accounting policies, as well as an assessment of the impact of various alternatives are in progress. Changes in accounting policies are likely and may materially impact the Company's consolidated financial statements.

3. DISCONTINUED OPERATIONS

During the June 2009 quarter, the Company sold its coated paper mill assets in St. Francisville, Louisiana, that had been indefinitely idled since July 2007. Sales proceeds totalled US $16 million, made up of US $6 million cash and US $10 million notes bearing interest at LIBOR plus 7%, repayable in three annual amounts of US $1 million starting in March 2011, two annual amounts of US $2 million starting in March 2014 and a final payment of US $3 million in March 2016. As a result, the Company generated a pre-tax gain of $16 million. Because the tax benefits had been accounted for prior to the Company's recapitalization, the tax effect relating to this transaction amounting to $5 million has been accounted for as contributed surplus. As this operation was the only coated paper facility owned by the Predecessor, its financial results have been reclassified as discontinued operations.

3. DISCONTINUED OPERATIONS (CONTINUED)

Condensed balance sheet from discontinued operations related to the St. Francisville facility is as follows:

	Sept. 26, 2009	Sept. 27, 2008
Inventories	**$ –**	$ 2
Accounts payable and accrued charges	**$ 3**	$ 3
Accrued benefit liability – Pension benefit plans	**20**	20
Accrued benefit liability – Other benefit plans	**13**	14
Environmental obligations	**–**	4
	$ 36	$ 41

Condensed earnings from discontinued operations related to the St. Francisville facility are as follows:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Sales	**$ –**	$ –	$ 2
Operating earnings (loss)	**$ 12**	$ (6)	$ (4)
Foreign exchange loss	**2**	1	–
Income taxes	**5**	–	–
Earnings (loss) from discontinued operations	**$ 5**	$ (7)	$ (4)
Earnings (loss) per common share from discontinued operations	**$ 0.05**	$ (0.07)	$ (0.05)

Condensed cash flows from discontinued operations related to the St. Francisville facility are as follows:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Cash flows from operating activities	**$ (7)**	$ (7)	$ (4)
Cash flows used by discontinued operations	**$ (7)**	$ (7)	$ (4)

4. INVENTORIES

	Sept. 26, 2009	Sept. 27, 2008
Finished goods	$ 120	$ 191
Logs and wood chips	102	119
Supplies and materials	97	104
	$ 319	$ 414

The reserves for net realizable values relating to logs and finished goods were as follows:

	Sept. 26, 2009	Sept. 27, 2008
Forest Products	$ 15	$ 11
Pulp	9	1
Paper	2	–
	$ 26	$ 12

5. INVESTMENTS IN JOINT VENTURES

At September 26, 2009, the Company no longer had interest in joint ventures.

The September 27, 2008, consolidated balance sheet includes the Company's proportionate share of assets and liabilities of 1387332 Ontario Limited (Marathon Pulp joint venture) and Temrex Forest Products Limited Partnership, each at 50%.

	Sept. 26, 2009	Sept. 27, 2008
Assets:		
Current assets	$ –	$ 29
Fixed assets and other	–	20
	$ –	$ 49
Liabilities and equity:		
Current liabilities	$ –	$ 31
Long-term debt	–	8
Other long-term liabilities	–	6
Equity	–	4
	$ –	$ 49

5. INVESTMENTS IN JOINT VENTURES (CONTINUED)

For the year ended September 26, 2009, the consolidated statements of operations and cash flows include the Company's proportionate share of the revenues and expenses of 1387332 Ontario Limited (Marathon Pulp joint venture) (to January 31, 2009) and Temrex Forest Products Limited Partnership (to August 29, 2009), each at 50%. For the seven-month period ended September 27, 2008, the consolidated statements of operations and cash flows include the Company's proportionate share of the revenues and expenses of 1387332 Ontario Limited (Marathon Pulp joint venture), Temlam Inc. (to August 30, 2008), and Temrex Forest Products Limited Partnership, each at 50%. For the five-month period ended February 29, 2008, the consolidated statements of the Predecessor include the amounts related to AV Cell Inc., 1387332 Ontario Limited (Marathon Pulp joint venture), Temlam Inc., and Temrex Forest Products Limited Partnership, each at 50%:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Sales	**$ 43**	$ 92	$ 58
Expenses	**44**	96	62
Loss before income taxes, interest, and minority interest	**$ (1)**	$ (4)	$ (4)
Net loss	**$ (1)**	$ (8)	$ (6)
Cash provided by (used in):			
Operating	**$ 3**	$ 2	$ (4)
Investing	**–**	(1)	–
Financing	**(2)**	–	1
	$ 1	$ 1	$ (3)

6. FIXED ASSETS

	Sept. 26, 2009			Sept. 27, 2008		
	Cost	**Accumulated depreciation**	**Net book value**	Cost	Accumulated depreciation	Net book value
Land	**$ 20**	**$ –**	**$ 20**	$ 20	$ –	$ 20
Production buildings and equipment:						
Pulp mills	**521**	**67**	**454**	485	21	464
Newsprint and paper mills	**49**	**7**	**42**	51	3	48
Sawmills	**107**	**39**	**68**	102	14	88
Roads and timber holdings	**7**	**–**	**7**	5	–	5
Other buildings and equipment	**20**	**3**	**17**	29	8	21
Assets under construction	**18**	**–**	**18**	22	–	22
	$ 742	**$ 116**	**$ 626**	$ 714	$ 46	$ 668

7. OTHER ASSETS

	Sept. 26, 2009	Sept. 27, 2008
Long-term loans to employees	**$ 2**	$ 2
Deferred pension costs	**2**	1
Investment tax credit and income taxes receivable	**1**	19
	$ 5	$ 22

8. OPERATING BANK LOANS

On February 29, 2008, the Company entered into a loan agreement with a syndicate of lenders for a revolving operating credit facility of $205 million maturing December 15, 2011, secured by all of the assets of the Company's material North American subsidiaries. This facility has a first priority charge over receivables and inventories having a carrying value of $417 million and a second priority charge over the remainder of the assets having a carrying value of $568 million. Interest is calculated based either on prime rate or banker's acceptances rate. As at September 26, 2009, $96 million (2008 – nil) were drawn on this facility and $39 million (2008 – $40 million) were reserved for letters of credit.

The French operations are supported by several mill specific "receivable factoring" agreements. As such, the borrowing base fluctuates periodically, depending on shipments and cash receipts. At the end of September 2009, the amount available was $73 million (2008 – $86 million), of which $51 million (2008 – $46 million) was unused.

9. LONG-TERM DEBT

	Sept. 26, 2009	Sept. 27, 2008
Tembec Inc.		
6% unsecured notes, repayable in semi-annual instalments of $2 million beginning March 30, 2008, with the balance due on September 30, 2012	$ 12	$ 16
Tembec Industries Inc.		
Term loan US $300 million secured facility due on February 28, 2012, bearing interest based on prime plus 6% or LIBOR plus 7%	328	310
Tembec SAS		
Unsecured term loans (€ 1 million), bearing interest at rates up to 1.5%, repayable and maturing at various dates to December 2013	2	2
6% term loan (€ 8 million)	–	12
Other Tembec SAS obligations	4	5
Tembec Envirofinance SAS		
Unsecured term loans (€ 23 million), non-interest bearing, repayable and maturing at various dates from June 2014 to June 2018	30	27
Tembec Energie SAS		
5.47% capital lease obligation (€ 5 million in 2009; € 6 million in 2008), repayable in equal monthly instalments, maturing on December 9, 2014	8	9
Bioenerg SAS		
5.5% secured term loan (€ 5 million), repayable in equal monthly instalments, maturing May 10, 2020	8	–
1387332 Ontario Limited (Marathon Pulp joint venture) (50% proportionate consolidation)	–	5
Other long-term obligations	10	10
	402	396
Less current portion	19	18
	$ 383	$ 378

9. LONG-TERM DEBT (CONTINUED)

On February 29, 2008, the Company entered into a loan agreement with a syndicate of lenders for a non-revolving term loan of US $300 million due February 28, 2012 secured by all of the assets of the Company's material North American subsidiaries. This facility has a first priority charge over all assets except receivables and inventories, where it has a second priority charge. Interest is calculated based either on prime rate or LIBOR rate. The loan agreement contains restrictive covenants, including restrictions on the incurrence of additional indebtedness, the payment of dividends, employee stock purchase plan payments, investments, the creation of liens, sale and leaseback transactions, certain amalgamations, mergers, consolidations and sales of assets and certain transactions with affiliates.

Instalments on consolidated long-term debt for the five years following September 26, 2009 are as follows:

2010	$ 19
2011	11
2012	339
2013	9
2014	8

10. OTHER LONG-TERM LIABILITIES AND CREDITS

	Sept. 26, 2009	Sept. 27, 2008
Accrued benefit liability – pension benefit plans	**$ 149**	$ 163
Accrued benefit liability – other benefit plans	**46**	45
Balance payable on acquisitions	**1**	1
Reforestation – BC operations	**8**	6
Environmental and other asset retirement obligations	**4**	3
Deferred government assistance	**3**	–
Other long-term commitments	**6**	6
Other	**2**	5
	$ 219	$ 229

11. SHARE CAPITAL

AUTHORIZED

Unlimited number of common voting shares, without par value.

Unlimited number of non-voting Class A preferred shares issuable in series without par value, with other attributes to be determined at time of issuance.

11,111,111 warrants convertible in equal amount of common shares and expiring on February 29, 2012. The warrants shall be deemed to be exercised and shall be automatically converted into new common shares when the 20-day volume-weighted average trading price of a single common share reaches or exceeds $12.00 or immediately prior to any transaction that would constitute a change of control.

(a) Common shares and warrants issued

	Sept. 26, 2009	Sept. 27, 2008
Issued and fully paid:		
100,000,000 common shares	**$ 564**	$ 564
11,094,340 (2008 – 11,095,839) warrants	**6**	6
	$ 570	$ 570

(b) Loss per share

The following table sets forth the computation of the basic and diluted loss per share:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Net loss from continuing operations	**$ (219)**	$ (41)	$ (98)
Net loss	**$ (214)**	$ (48)	$ (102)
Weighted average number of common shares outstanding	**100,000,000**	100,000,000	85,616,232
Dilutive effects:			
Employees stock options	**–**	–	–
Weighted average number of diluted common shares outstanding	**100,000,000**	100,000,000	85,616,232
Basic and diluted loss per share from continuing operations	**$ (2.19)**	$ (0.41)	$ (1.14)
Basic and diluted loss per share	**$ (2.14)**	$ (0.48)	$ (1.19)

11. SHARE CAPITAL (CONTINUED)

(b) Loss per share (continued)

The diluted loss per share is the same as the basic loss per share as the dilutive factors result in a decrease in the loss per share.

(c) Stock-based compensation

Under the Long-Term Incentive Plan, the Company may, from time to time, grant options to its employees. The plan provides for the issuance of common shares at an exercise price equal to the market price of the Company's common shares on the date of the grant. These options vest over a five-year period and expire ten years from the date of issue. No options have been granted since 2006. No compensation expense was recorded for the seven months ended September 27, 2008, and for the year ended September 26, 2009.

The following table summarizes the changes in options outstanding and the impact on weighted average per share exercise price during the year:

	2009		2008	
	Shares	**Weighted average exercise price**	Shares	Weighted average exercise price
Balance, beginning of year – old options	–	$ –	3,668,019	$ 6.28
Options expired	–	–	(198,000)	6.18
Balance prior to recapitalization	–	–	3,470,019	6.28
Cancellation of old options	–	–	(3,470,019)	6.28
Recapitalized options	**201,456**	**107.41**	202,649	107.56
Options expired	**(16,425)**	**132.70**	(1,193)	132.25
Balance, end of year	**185,031**	**$ 105.17**	201,456	$ 107.41
Exercisable, end of year	**149,103**	**$ 117.54**	135,465	$ 129.76

11. SHARE CAPITAL (CONTINUED)

(c) Stock-based compensation (continued)

The following table summarizes the weighted average per share exercise price and the weighted remaining contractual life of the options outstanding as at September 26, 2009:

	Outstanding options			Exercisable options	
Year granted	Number of options	Weighted remaining contractual life	Weighted average exercise price	Number of options	Weighted average exercise price
2000	17,495	0.31	$ 268.744	17,495	$ 268.744
2001	4,089	1.29	195.466	4,089	195.466
2002	12,087	2.12	185.118	12,087	185.118
2003	8,741	3.20	176.313	8,741	176.313
2004	14,079	4.16	139.319	14,079	139.319
2005	77,440	5.43	87.403	61,952	87.403
2006	51,100	6.15	28.363	30,660	28.363
	185,031	4.63	$ 105.165	149,103	$ 117.539

During fiscal year 2006, the Predecessor established a performance share units (PSUs) plan for designated senior executives. Under the terms of this plan, senior executives may be eligible to an annual incentive remuneration paid to them in the form of PSUs. Each PSU is equivalent in value to a common share of the Company and is notionally credited with dividends when shareholders receive dividends from the Company. A PSU is paid to an executive following a three-year vesting period and is payable in the form of either cash or common shares of the Company, which are purchased on the open market. As at September 26, 2009 and September 27, 2008, 93,485 PSUs were outstanding.

During fiscal 2009, the Company replaced the PSU plan with a performance-conditioned restricted share unit (PCRSU) plan. Vesting of the PCRSUs is based entirely on the attainment of pre-established performance objectives over a three-year period. As at September 26, 2009, none of the 2,885,000 PCRSUs issued in fiscal 2009 have vested, 95,000 PCRSUs were cancelled as a result of participant departures, and 2,790,000 remain outstanding.

Non-employee directors of the Company are also given the option to receive part of their annual retainer, meeting fees and awards under the Directors' Share Award Plan in the form of DSUs. A DSU is paid to a director upon termination of Board service and is payable in the form of cash. As at September 26, 2009 and September 27, 2008, 411,222 DSUs were outstanding and no significant amount was payable under this plan.

Under the Employee Share Purchase Plan, employees may purchase common shares of the Company up to 10% of their base salary or wage. The Company contributes 25% of the amount invested by the employee if the shares are held for a minimum period of time. Purchases of common shares under this plan occur on the open market. In 2009 and 2008, the cost of share purchases for the benefit of the employees was insignificant.

12. GUARANTEES, COMMITMENTS AND CONTINGENCIES

GUARANTEES

The Company and certain of its subsidiaries have granted irrevocable letters of credit, issued by high rated financial institutions, to third parties to indemnify them in the event the Company does not perform its contractual obligations. The Company has not recorded any additional liability with respect to these guarantees, as the Company does not expect to make any payments in excess of what is recorded in the Company's financial statements. The letters of credit mature at various dates in fiscal 2010.

LUMBER DUTIES AND EXPORT TAXES

Effective October 12, 2006, the governments of Canada and the United States implemented an agreement for the settlement of the softwood lumber dispute. The Softwood Lumber Agreement (SLA) requires that an export tax be collected by the Government of Canada, based on the price and volume of lumber shipped. The SLA had an effective date of October 12, 2006, at which time the U.S. Department of Commerce (USDOC) revoked all existing countervailing and antidumping duty orders on softwood lumber shipped to the U.S. from Canada.

COMMITMENTS

The Company has entered into operating leases for property, plant and equipment for expected cash outflows of $23 million. Outflows for the five years following September 26, 2009 are as follows:

2010	$ 6
2011	5
2012	5
2013	2
2014	1

CONTINGENCIES

Tembec is party to claims and lawsuits, which are being contested. Management believes that the outcome of these claims and lawsuits will not have a material adverse effect on Tembec's financial condition, earnings or liquidity.

13. DEPRECIATION AND AMORTIZATION

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Fixed assets	**$ 73**	$ 51	$ 69
Deferred development costs and other	**–**	–	3
	$ 73	$ 51	$ 72

14. OTHER ITEMS

2009

RESTRUCTURING AND ASSET IMPAIRMENT CHARGES

During 2009, the Company recognized an impairment charge of $2 million related to the newsprint facility in Pine Falls, Manitoba. These assets are included in the paper segment.

On February 13, 2009, Marathon Pulp Inc. (MPI) filed a notice of intention to make a proposal under the Bankruptcy and Insolvency Act. As a result of these filings, the Company concluded that, based on Canadian GAAP, it had lost joint control over MPI and ceased to apply the proportionate consolidation method to account for its 50% interest in MPI. As of the most recent reporting date of January 31, 2009, the Company's proportionate share of net liabilities exceeded the net assets by $8 million, resulting in a gain from the change in accounting for this investment. The Company absorbed a charge of $4 million relating to trade amounts owing from MPI. The net effect overall was a $4 million gain.

The following table provides information on the assets and liabilities at the date on which the Company ceased to consolidate the accounts:

Marathon Pulp Inc.

Current assets	$	14
Long-term assets		6
Current liabilities		(18)
Long-term liabilities		(10)
Net assets deficiency	$	(8)

Company

Current assets	$	4
Net gain recognized upon deconsolidation	$	(4)

During the March 2009 quarter, the Company announced the permanent closure of the Mattawa, Ontario, sawmill. The facility had been idled since July 2008. The Company recorded a charge of $2 million relating to severance and other relating items.

Also during the March 2009 quarter, the Company announced the reduction of a number of staff positions and recorded a charge of $2 million for related severance costs.

Also during the March 2009 quarter, the Company settled certain product liabilities claims relating to a U.S. chemical subsidiary. Costs associated with this claim, net of insurance proceeds, are estimated at $1 million.

14. OTHER ITEMS (CONTINUED)

2009 (CONTINUED)

GAIN ON LAND SALES AND OTHER

During the September 2009 quarter, the Company recorded a net gain of $5 million on the sale of its 50% equity interest in Temrex Forest Products LP (Temrex). The Temrex operation included two sawmills in the Gaspé, Quebec region.

During the March 2009 quarter, the Company recorded a net gain of $1 million on the sale of a previously written-off paper machine.

2008

RESTRUCTURING AND ASSET IMPAIRMENT CHARGES

On September 15, 2008, Temlam Inc. and Jager Building Systems Inc., a subsidiary of Temlam Inc., made voluntary assignments in bankruptcy. As a result of these filings, the Company concluded that, based on Canadian GAAP, it had lost joint control over Temlam Inc. and ceased to apply the proportionate consolidation method to account for its 50% interest in Temlam Inc. As of the most recent reporting date of August 30, 2008, the Company's proportionate share of net liabilities exceeded the net assets by $10 million, resulting in a gain from the change in accounting for this investment. The Company absorbed a charge of $6 million relating to trade amounts owing from Temlam Inc. and Jager Building Systems Inc. The Company also recognized a $1 million obligation to a creditor of Jager Building Systems Inc. The net effect overall was a $3 million gain.

The following table provides information on the assets and liabilities at the date the Company ceased to consolidate the accounts:

Temlam Inc.

Current assets	$	19
Long-term assets		30
Current liabilities		(16)
Long-term liabilities		(43)
Net assets deficiency	$	(10)

Company

Current assets	$	6
Other obligations		1
Related Company accounts	$	7
Net gain recognized upon deconsolidation	$	(3)

14. OTHER ITEMS (CONTINUED)

2008 (CONTINUED)

RESTRUCTURING AND ASSET IMPAIRMENT CHARGES (CONTINUED)

In October 2008, the Company assumed the rank of secured lender to Temlam by effecting a payment of $22 million. The Company has recorded a current receivable of $22 million representing the expected recovery value of the Temlam assets and is anticipated to be recovered within one year.

During the February 2008 period, the Predecessor recorded a non-cash charge of $1 million relating to the write-down of fixed assets at its Temiscaming facility. As well, $2 million of mill closure provisions were reversed.

During the December 2007 quarter, the Predecessor recorded a non-cash charge of $2 million relating to the write-down of its investment in the failed Gaspesia project. As well, $1 million of mill closure provisions were reversed.

GAIN ON LAND SALES AND OTHER

During the June 2008 quarter, the Company recorded a net gain of $2 million on the sale of its 20% of the 25% equity interest it held in the issued and outstanding shares of both AV Nackawic Inc. and AV Cell Inc.

During the December 2007 quarter, the Predecessor completed the sale of a number of land properties and recorded a gain of $16 million. As well, the Predecessor reduced its participation in the equity of AV Cell Inc. from 50% to 25% and recorded a gain of $4 million. The Predecessor also ceased applying the proportionate consolidation method to this investment and began applying the equity method.

The following table provides an analysis of the other items by business segment of the Company:

	Year ended September 26, 2009					
	Forest Products	Pulp	Paper	Chemicals	Corporate and other	Consolidated
Gain on sales – other	$ (5)	$ –	$ –	$ –	$ (1)	$ (6)
Other	–	(4)	2	1	–	(1)
Severance, other labour-related and idling costs	2	–	–	–	2	4
	$ (3)	$ (4)	$ 2	$ 1	$ 1	$ (3)

14. OTHER ITEMS (CONTINUED)

	Seven months ended September 27, 2008		
	Forest Products	Corporate and other	Consolidated
Investments	$ –	$ (2)	$ (2)
Other	(3)	–	(3)
	$ (3)	$ (2)	$ (5)

The following table provides an analysis of the other items by business segment of the Predecessor:

	Five months ended February 29, 2008				
	Forest Products	Pulp	Paper	Corporate and other	Consolidated
Investments	$ –	$ (4)	$ –	$ 2	$ (2)
Gain on land sales	(16)	–	–	–	(16)
Other	(2)	1	(1)	–	(2)
	$ (18)	$ (3)	$ (1)	$ 2	$ (20)

The mill closure provisions are no longer significant and therefore not reported.

15. INTEREST, FOREIGN EXCHANGE AND OTHER

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Interest on long-term debt	**$ 33**	$ 20	$ 27
Interest on short-term debt	**4**	4	4
	37	24	31
Amortization of deferred financing costs	**–**	–	2
Derivative financial instruments gain	**(2)**	(2)	–
Exchange gain on conversion of integrated foreign subsidiaries	**(5)**	–	(4)
Other foreign exchange items	**(11)**	(9)	2
Bank charges and other financing expenses	**3**	–	1
	(15)	(11)	1
	$ 22	$ 13	$ 32

16. INCOME TAXES

The tax effects of the significant components of temporary differences that give rise to future income tax assets and liabilities are as follows:

	Sept. 26, 2009	Sept. 27, 2008
Future income tax assets:		
Non-capital loss carryforwards and pool of deductible scientific research and development expenditures	$ 394	$ 328
Fixed assets	23	44
Employee future benefits	63	67
Financing charges	12	17
Other	14	24
Valuation allowance	(490)	(465)
	16	15
Future income tax liabilities:		
Other	(16)	(17)
Net future income tax liabilities	$ –	$ (2)

Certain subsidiaries have accumulated the following losses and deductions for income tax purposes, which may be carried forward to reduce taxable income and taxes payable in future years.

	Amounts	Expiring dates
Non-capital loss carried forward for Canadian subsidiaries	$ 932	2010 to 2029
Non-capital loss carried forward for foreign subsidiaries	119	2024 to 2029
Pool of deductible scientific research and experimental development	362	Unlimited

16. INCOME TAXES (CONTINUED)

The reconciliation of income taxes calculated at the statutory rate to the actual tax provision is as follows:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Loss from continuing operations before income taxes and minority interest	**$ (221)**	$ (36)	$ (92)
Income tax based on combined federal and provincial income tax rates of 30.9% (2008 – 31.9%)	**$ (68)**	$ (12)	$ (29)
Increase (decrease) resulting from:			
Future income taxes adjustment due to rate enactments	**–**	–	4
Change in valuation allowance	**62**	17	35
Difference in statutory income tax rate	**–**	(3)	2
Permanent differences:			
Non-taxable portion of exchange loss (gain) on long-term debt	**2**	2	(2)
Non-deductible (taxable) exchange loss (gain) on conversion of integrated foreign subsidiaries	**3**	1	(1)
Other permanent differences	**–**	–	(3)
	67	17	35
Income tax expense (recovery)	**$ (1)**	$ 5	$ 6
Income taxes:			
Current	**$ –**	$ 4	$ –
Future	**(1)**	1	6
Income tax expense (recovery)	**$ (1)**	$ 5	$ 6

17. EMPLOYEE FUTURE BENEFITS

DEFINED CONTRIBUTION PENSION PLANS

The Company contributes to defined contribution pension plans, provincial and labour sponsored pension plans, group registered retirement savings plans, deferred profit sharing plans, and 401(k) plans. The pension expense under these plans is equal to the Company's contribution. The 2009 pension expense was $8 million ($6 million for the seven-month period ended September 27, 2008, and $5 million for the five-month period ended February 29, 2008).

DEFINED BENEFIT PENSION PLANS

The Company has several defined benefit pension plans. Non-unionized employees in Canada joining the Company after January 1, 2000, participate in defined contribution pension plans. Some of the defined benefit pension plans are contributory. The pension expense and the obligation related to the defined benefit pension plans are actuarially determined using management's most probable assumptions.

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

OTHER EMPLOYEE FUTURE DEFINED BENEFIT PLANS

The Company offers post-retirement life insurance, health care and dental care plans to some of its retirees. The Company offers post-employment health care and dental care plans to disabled employees. The Company also assumes post-employment life insurance coverage of some of its disabled employees.

The post-retirement and post-employment benefit expenses and the obligations related to the defined benefit plans are actuarially determined using management's most probable assumptions.

Actuarial valuations of these plans for accounting purposes are conducted on a triennial basis unless there are significant changes affecting the plans. The latest actuarial valuations were conducted as at April 1, 2007 or May 1, 2009.

The post-retirement and post-employment benefit plans are unfunded.

DESCRIPTION OF FUND ASSETS

The assets of the registered defined benefit pension plans are held by an independent trustee and accounted for separately in the Company's pension funds. Based on the fair value of assets held at June 30, 2009, the defined benefit pension plan assets were comprised of 1% (1% in 2008) in cash and short-term investments, 5% (6% in 2008) in real estate, 44% (45% in 2008) in bonds and 50% (48% in 2008) in Canadian, U.S. and foreign equity.

FUNDING POLICY

The Company's funding policy for registered defined benefit pension plans is to contribute annually the amount required to provide for benefits earned in the year and to fund past service obligations over periods not exceeding those permitted by the applicable regulatory authorities. Actuarial valuations for funding purposes are conducted on a triennial basis, unless required earlier by pension legislation or as deemed appropriate by management from time to time. The latest funding actuarial valuations were conducted for eight plans on December 31, 2008, five plans on December 31, 2007, and three plans on December 31, 2006. The two pension plans related to discontinued operations were last valued on January 1, 2009.

INVESTMENT POLICY

The Company follows a disciplined investment strategy, which provides diversification of investments by asset class, foreign currency, sector or company. The Corporate Governance and Human Resources Committee of the Board of Directors has approved an investment policy that establishes long-term asset mix targets based on a review of historical returns achieved by world-wide investment markets. Investment managers may deviate from these targets to the extent permitted by the investment policy. Their performance is evaluated in relation to the market performance on the target mix.

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

INFORMATION ABOUT THE COMPANY'S DEFINED BENEFIT PLANS IN AGGREGATE

The Company measures its accrued benefit obligation and the fair value of plan assets for accounting purposes as at June 30 of each year. The accrued benefit obligation and the fair value of plan assets for accounting purposes were also measured as at February 29, 2008, as required by fresh start accounting.

The following tables present the change in the accrued benefit obligation for the defined benefit plans as calculated by independent actuaries and the change in the fair value of plan assets:

Change in accrued benefit obligations for defined benefit plans:

	Pension plans			Other benefit plans		
	Company	Company	Predecessor	**Company**	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008	**Year ended Sept. 26, 2009**	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Accrued benefit obligation, at beginning of year	**$ 907**	$ 920	$ 882	**$ 59**	$ 58	$ 53
Current service cost	**15**	10	6	**1**	–	–
Interest cost	**49**	29	20	**3**	2	1
Employee contributions	**3**	2	1	**–**	–	–
Benefits paid	**(56)**	(38)	(25)	**(3)**	(1)	(1)
Divestitures	**(44)**	–	–	**(3)**	–	–
Plan amendments	**–**	–	1	**(4)**	8	3
Actuarial loss (gain)	**(41)**	(23)	33	**–**	(9)	1
Foreign exchange rate changes and other adjustments	**7**	7	2	**–**	–	–
Obligation being settled	**(12)**	–	–	**–**	–	–
Post-employment and other	**–**	–	–	**2**	1	1
Accrued benefit obligation, at end of year	**$ 828**	$ 907	$ 920	**$ 55**	$ 59	$ 58
Accrued benefit obligation, at end of year – discontinued operations	**$ 115**	$ 110	$ 107	**$ 6**	$ 7	$ 14

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

INFORMATION ABOUT THE COMPANY'S DEFINED BENEFIT PLANS IN AGGREGATE (CONTINUED)

Change in fair value of plan assets for defined benefit plans:

	Pension plans			Other benefit plans		
	Company	Company	Predecessor	**Company**	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008	**Year ended Sept. 26, 2009**	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Fair value of defined benefit plan assets, at beginning of year	**$ 736**	$ 726	$ 751	**$ –**	$ –	$ –
Actual return on plan assets	**(71)**	18	(16)	**–**	–	–
Employer contributions	**38**	23	15	**3**	1	1
Employee contributions	**3**	2	1	**–**	–	–
Benefits paid	**(56)**	(38)	(25)	**(3)**	(1)	(1)
Divestitures	**(36)**	–	–	**–**	–	–
Foreign exchange rate changes and other adjustments	**7**	5	–	**–**	–	–
Settlement payments	**(15)**	–	–	**–**	–	–
Fair value of defined benefit plan assets, at end of year	**$ 606**	$ 736	$ 726	**$ –**	$ –	$ –
Fair value of defined benefit plan assets, at end of year – discontinued operations	**$ 73**	$ 87	$ 87	**$ –**	$ –	$ –

FUNDED STATUS

The following table presents the difference between the fair value of plan assets and the actuarially determined accrued benefit obligation as at June 30, 2009, June 30, 2008, and February 29, 2008 for defined benefit plans. This difference is also referred to as either the deficit or surplus, as the case may be, or the funded status of the plans.

The table further reconciles the amount of surplus or deficit (funded status) to the net amount recognized in the consolidated balance sheets. The difference between the funded status and the net amount recognized in the consolidated balance sheets, in accordance with Canadian GAAP, represents the portion of the surplus or deficit not yet recognized for accounting purposes. This approach allows for a gradual recognition of changes in accrued benefit obligations and plan performance over the expected average remaining life of the employee group covered by the plans as described in note 2.

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

FUNDED STATUS (CONTINUED)

Reconciliation of funded status for defined benefit plans:

	Pension plans		Other benefit plans	
	Sept. 26, 2009	Sept. 27, 2008	**Sept. 26, 2009**	Sept. 27, 2008
Fair value of plan assets	**$ 606**	$ 736	**$ –**	$ –
Accrued benefit obligation	**(828)**	(907)	**(55)**	(59)
Plan deficit	**(222)**	(171)	**(55)**	(59)
Plan deficit – discontinued operations	**(42)**	(23)	**(6)**	(7)
Employer contribution after measurement date (June 30)	**5**	9	**1**	1
Unamortized past service costs	**–**	–	**3**	8
Unamortized net actuarial loss (gain)	**50**	(20)	**(8)**	(9)
Accrued benefit liability	**$ (167)**	$ (182)	**$ (59)**	$ (59)
Accrued benefit liability – discontinued operations	**$ (20)**	$ (20)	**$ (13)**	$ (14)

Amounts recognized in the consolidated balance sheets for defined benefit plans:

	Pension plans		Other benefit plans	
	Sept. 26, 2009	Sept. 27, 2008	**Sept. 26, 2009**	Sept. 27, 2008
Deferred pension costs	**$ 2**	$ 1	**$ –**	$ –
Accrued benefit liability	**(169)**	(183)	**(59)**	(59)
Accrued benefit liability	**(167)**	(182)	**(59)**	(59)
Accrued benefit liability – discontinued operations	**$ (20)**	$ (20)	**$ (13)**	$ (14)

The accrued benefit obligations in excess of fair value of plan assets at year-end with respect to defined benefit plans that are not fully funded are as follows:

	Pension plans		Other benefit plans	
	Sept. 26, 2009	Sept. 27, 2008	**Sept. 26, 2009**	Sept. 27, 2008
Fair value of plan assets	**$ 605**	$ 682	**$ –**	$ –
Accrued benefit obligations	**(827)**	(855)	**(55)**	(59)
Plan deficit	**(222)**	(173)	**(55)**	(59)
Plan deficit – discontinued operations	**$ (42)**	$ (23)	**$ (6)**	$ (7)

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

COMPONENTS OF NET PERIODIC COST FOR DEFINED BENEFIT PLANS

Components of net periodic benefit cost for defined benefit pension plans:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Current service cost	**$ 15**	$ 10	$ 6
Interest cost	**49**	29	20
Actual return on plan assets	**71**	(18)	16
Actuarial loss (gain)	**(41)**	(23)	33
Settlement loss	**3**	–	–
Plan amendments and other	**–**	–	1
Net expense (income) before adjustments to recognize the long-term nature of the plans	**97**	(2)	76
Difference between expected and actual return on plan assets	**(119)**	(13)	(38)
Difference between net actuarial loss (gain) and actuarial loss (gain)	**41**	23	(31)
Difference between amortization of past service costs for the year and actual plan amendments for the year	**–**	–	(1)
Net periodic benefit cost	**$ 19**	$ 8	$ 6
Net periodic benefit cost – discontinued operations	**$ 1**	$ –	$ –

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

COMPONENTS OF NET PERIODIC COST FOR DEFINED BENEFIT PLANS (CONTINUED)

Components of net periodic benefit cost for other defined benefit plans:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Current service cost	**$ 1**	$ –	$ –
Interest cost	**2**	2	1
Post-employment	**2**	1	1
Plan amendments and other	**(4)**	8	3
Actuarial loss (gain)	**–**	(9)	1
Net expense before adjustments to recognize the long-term nature of the plans	**1**	2	6
Difference between amortization of past service costs for the year and actual plan amendment for the period	**5**	(8)	(3)
Difference between net actuarial loss (gain) and actuarial loss (gain)	**(1)**	9	(1)
Net periodic benefit cost	**$ 5**	$ 3	$ 2
Net periodic benefit cost – discontinued operations	**$ –**	$ –	$ –

ASSUMPTIONS

Weighted average significant assumptions for defined benefit pension plans:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Accrued benefit obligation at end of year:			
Discount rate	**5.73%**	5.56%	5.35%
Rate of compensation increase	**2.61%**	3.03%	3.03%
Net periodic benefit cost for the year:			
Discount rate	**5.56%**	5.35%	5.55%
Rate of compensation increase	**3.03%**	3.03%	3.03%
Expected long-term return on assets	**6.77%**	7.29%	7.27%

17. EMPLOYEE FUTURE BENEFITS (CONTINUED)

ASSUMPTIONS (CONTINUED)

Weighted average significant assumptions for other defined benefit plans:

	Company	Company	Predecessor
	Year ended Sept. 26, 2009	Seven months ended Sept. 27, 2008	Five months ended Feb. 29, 2008
Accrued benefit obligation at end of year:			
Discount rate	**5.48%**	5.56%	5.39%
Rate of compensation increase	**2.50%**	3.00%	3.00%
Benefit cost for the year:			
Discount rate	**5.56%**	5.39%	5.66%
Rate of compensation increase	**3.00%**	3.00%	3.00%
Assumed healthcare cost trend rate at end of year:			
Initial healthcare cost trend	**8.39%**	8.89%	9.06%
Annual rate of decline in trend rate	**0.50%**	0.53%	1.00%
Ultimate healthcare cost trend rate	**5.00%**	5.00%	5.00%
Effect of change in healthcare cost trend rate (1% increase)			
Total of service cost and interest cost	**$ –**	$ –	$ –
Accrued benefit obligation	**$ 4**	$ 4	$ 4
Effect of change in healthcare cost trend rate (1% decrease)			
Total of service cost and interest cost	**$ –**	$ –	$ –
Accrued benefit obligation	**$ (3)**	$ (4)	$ (4)

18. FINANCIAL INSTRUMENTS

FAIR VALUE

The carrying amount of cash and cash equivalents, derivative financial instruments, accounts receivable, operating bank loans and accounts payable and accrued charges approximates their fair values because of the near-term maturity of those instruments. The fair value of long-term debt which is not actively traded, and balance payable on acquisition of companies has been determined based on management's best estimate of fair value to renegotiate these financial instruments with similar terms at the respective year-end dates.

The carrying value and the fair value of long-term debt and balance payable on acquisition of companies are as follows:

	Sept. 26, 2009	Sept. 27, 2008
Carrying value	**$ 403**	$ 397
Fair value	**403**	397

18. FINANCIAL INSTRUMENTS (CONTINUED)

FINANCIAL RISK MANAGEMENT

OVERVIEW

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk
  - Foreign currency rate risk
  - Interest rate risk
  - Commodity price and operational risk

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management policy. The policy defines the method by which the Company manages its risk through properly and prudently administering the Company's financial assets, liabilities and derivatives. Internal Audit measures the adequacy of the business control systems through the execution of an Internal Audit Plan approved by the Audit Committee.

CREDIT RISK MANAGEMENT

Credit risk arises from the possibility that entities to which the Company sells products may experience financial difficulty and be unable to fulfill their contractual obligations. The Company does not have a significant exposure to any individual customer or counterparty. As required in the Risk Management Policy, the Company reviews a new customer's credit history before extending credit and conducts regular reviews of its existing customers' credit performance. All credit limits are subject to evaluation and revision at any time based on changes in levels of creditworthiness and must be reviewed at least once per year. Sales orders cannot be processed unless a credit limit has been properly approved. The Company may require payment guarantees, such as letters of credit, or obtains credit insurance coverage. Bad debt write-offs have been insignificant in the past. The allowance for doubtful accounts for the Company as at September 26, 2009, was $2 million (2008 – $4 million).

EXPOSURE TO CREDIT RISK

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	Sept. 26, 2009	Sept. 27, 2008
Loans and receivables	$ 300	$ 380
Cash and cash equivalents	105	113

18. FINANCIAL INSTRUMENTS (CONTINUED)

EXPOSURE TO CREDIT RISK (CONTINUED)

The maximum exposure to credit risk for trade accounts receivable as at September 26, 2009, by geographical region was as follows:

	Sept. 26, 2009	Sept. 27, 2008
Canada	$ 23	$ 40
United States	54	85
Pacific Rim and India	31	30
United Kingdom, Europe and other	97	132
	205	287
Allowance for doubtful accounts	(2)	(4)
Trade receivables net	203	283
Investment in Temlam (note 14)	23	22
Other receivables including input tax credits	57	66
Accounts receivable	$ 283	$ 371

The aging of trade accounts receivable was as follows:

	September 26, 2009		September 27, 2008	
	Gross	Allowance	Gross	Allowance
Not past due	$ 179	$ –	$ 243	$ –
Past due 0-30 days	20	–	34	–
Past due 31-60 days	4	–	5	–
Past due 61-90 days	–	–	1	–
More than 90 days	2	2	4	4
	$ 205	$ 2	$ 287	$ 4

The movement in the allowance for doubtful accounts receivable in respect to trade accounts receivable was as follows:

	Sept. 26, 2009	Sept. 27, 2008
Opening balance	$ 4	$ 3
Bad debt recognized (written off)	(2)	1
Ending balance	$ 2	$ 4

18. FINANCIAL INSTRUMENTS (CONTINUED)

LIQUIDITY RISK MANAGEMENT

Liquidity risk arises from the possibility that the Company will not be able to meet its financial obligations as they fall due. The Company has an objective of maintaining liquidity equal to 12 months of capital expenditures, interest and principal repayments and seasonal working capital requirements, which would require approximately $150 million to $200 million of liquidity.

EXPOSURE TO LIQUIDITY RISK

A liquidity reserve in the form of cash and undrawn revolving credit facilities is maintained to assist in the solvency and financial flexibility of the Company. Liquidity reserves as at September 26, 2009, totalled $170 million (2008 – $319 million). Repayment of amounts due within one year may also be funded by normal collection of current trade accounts receivable and cash on hand.

The following are the contractual maturities of financial liabilities, including interest payments and excluding the impact of netting agreements:

							September 26, 2009
	Carrying amount	Contractual cash flows	6 months or less	6-12 months	1-2 years	2-5 years	More than 5 years
Secured bank loans	$ 352	$ 414	$ 14	$ 14	$ 28	$ 350	$ 8
Unsecured loans	50	59	5	7	11	24	12
Operating bank loans	118	118	118	–	–	–	–
Trade and others	281	281	281	–	–	–	–
	$ 801	$ 872	$ 418	$ 21	$ 39	$ 374	$ 20

FOREIGN CURRENCY RATE RISK MANAGEMENT

The Company is exposed to currency risk on sales, purchases and long-term debt that are denominated in a currency other than the respective functional currencies of foreign and domestic operations, primarily the Canadian dollar and euro. The currencies in which these transactions are primarily denominated are the Canadian dollar, US dollar and euro.

The Company's revenues for most of its products are affected by fluctuations in the relative exchange rates of the Canadian dollar, the US dollar and the euro. The prices for many products, including those sold in Canada and Europe, are generally driven by US $ reference prices of similar products. The Company generates approximately $1.5 billion of US $ denominated sales annually from its Canadian and European operations. As a result, any decrease in the value of US dollar relative to the Canadian dollar and the euro reduces the amount of revenues realized on sales in local currency. In addition, since business units purchase the majority of their production inputs in local currency, fluctuations in foreign exchange can significantly affect the unit's relative cost position when compared to competing manufacturing sites in other currency jurisdictions. This could result in the unit's inability to maintain its operations during period of low prices and/or demand.

18. FINANCIAL INSTRUMENTS (CONTINUED)

FOREIGN CURRENCY RATE RISK MANAGEMENT (CONTINUED)

SENSITIVITY ANALYSIS

Based on 2010 planned sales volumes and prices, the following table illustrates the impact of a 1% change in the value of the US dollar versus the Canadian dollar and the euro. For illustrative purposes, an increase of 1% in the value of the US dollar is assumed. A decrease would have the opposite effects of those shown below:

Sales increase	$	15
Cost of sales increase		2
Gross margin		13
Loss on US $ debt translation		3
Pre-tax earnings increase	$	10

Direct US $ purchases of raw materials, supplies and services provided a partial offset to the impact on sales. This does not include the potential indirect impact of currency on the cost of items purchased in the local currency.

Interest expense on the Company's US $ denominated debt provides a small offset to its US $ exposure. To further reduce the impact of fluctuations in the value of the US dollar, the Company has adopted a policy which allows for hedging up to 50% of its anticipated US $ receipts for up to 36 months in duration. The Company does not currently hold any significant foreign exchange contracts.

INTEREST RATE RISK MANAGEMENT

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

SENSITIVITY ANALYSIS

As at September 26, 2009, if interest rates had been 100 basis points higher (lower), related to the US $300-million term loan, interest would have increased (decreased) by US $3 million annually.

18. FINANCIAL INSTRUMENTS (CONTINUED)

COMMODITY PRICE AND OPERATIONAL RISK MANAGEMENT

The Company's financial performance is dependent on the selling prices of its products. The markets for most lumber, pulp and paper products are cyclical and are influenced by a variety of factors. These factors include periods of excess product supply due to industry capacity additions, periods of decreased demand due to weak general economic activity, inventory de-stocking by customers, and fluctuations in currency exchange rates. During periods of low prices, the Company is subject to reduced revenues and margins, resulting in substantial declines in profitability and possibly net losses. The Company may periodically purchase lumber, pulp and newsprint price hedges to mitigate the impact of price volatility. The Company did not hold any significant product price hedges at September 26, 2009. At September 27, 2008, the Company held lumber futures equal to approximately 3% of its annual SPF lumber capacity. The fair value of the contracts was $1 million.

The manufacturing activities conducted by the Company's operations are subject to a number of risks, including availability and price of fibre and competitive prices for purchased energy and raw materials. To mitigate the impact of price fluctuations, the Company may periodically purchase hedges. The Company does not currently hold any significant hedges.

19. CAPITAL MANAGEMENT

It is the Company's objective to manage its capital to ensure adequate capital resources exist to support operations while maintaining its business growth. The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk of characteristics of the underlying assets.

The Company monitors capital on the basis of net debt to total capitalization ratio. Net debt is calculated as a total debt (long-term debt plus bank indebtedness/operating lines) less cash and cash equivalents. Total capitalization includes net debt plus future income taxes, other long-term liabilities, shareholders' equity, deferred credits and other.

The Company's strategy is to maintain a net debt to total capitalization ratio of 40% or less. The objective is to keep a strong balance sheet and maintain the ability of the Company to access capital markets at favourable rates. The debt to total capitalization ratio for the Company as at September 26, 2009 and September 27, 2008 was 42% and 30%, respectively.

20. SUBSEQUENT EVENT

CIT Business Credit Canada Inc. (CITBCC) is the agent of the Company's $205-million revolving operating credit facility. CITBCC is jointly owned by Canadian Imperial Bank of Commerce and CIT Group, Inc. (CIT). On November 1, 2009, CIT filed under Chapter 11 bankruptcy protection from creditors in the United States and announced a pre-packaged plan of reorganization for CIT and a subsidiary that will restructure its debt and streamline its capital structure; none of CIT's operating subsidiaries were included in this filing.

While the Company understands that CITBCC has separate and adequate funding, the Company had considered it prudent to draw under this facility. A further amount of $45 million was drawn in July 2009. CITBCC's commitment is $100 million of the $205-million facility. Failure by any lender to fund its rateable share does not relieve the other lenders of their obligations to fund their rateable shares.

21. COMPARATIVE FIGURES

Certain 2008 comparative figures have been reclassified to conform with the financial statement presentation adopted for 2009.