Message to Shareholders

Fiscal 2010 was a transformational year for Tembec from a number of perspectives. The Company's health and safety performance, financial performance and balance sheet were all significantly improved during the year. The Company also took major steps in the implementation of its strategic plan.

In 2007, the Company refocused its efforts on its health and safety performance which was unacceptable, and it implemented a multi-year plan to become a world-class performer in our industry. This plan is designed to focus on raising the level of awareness and accountability at all levels of the organization from the President and CEO to the frontline workers of the Company. Since the inception of the plan, the OIR (OSHA Incident Rate) has been reduced by 56%, including a 30% improvement between 2009 and 2010.

All of the Company's business groups made significant progress in their financial performance versus 2009 resulting in vastly improved consolidated results. EBITDA was $132 million for the year, a $240 million improvement over the previous year. A significant amount of the increase was due to more favourable market conditions versus 2009. Capacity rationalization and stronger demand led to a rise in selling prices for the Company's products. Ongoing cost reduction efforts also contributed to the improvement in the Company's results.

A significant amount of focus was placed on improving the Company's balance sheet throughout the year. In August, the Company issued US $255 million of senior secured notes with a maturity of December 2018. The proceeds were used to pay down the US $300 million term debt due to mature in February 2012. Overall, net debt was reduced by approximately $200 million on a year over year basis.

The Company's Board of Directors has been working with management on a plan to reposition the Company's portfolio of assets and improve returns for shareholders. Two major steps were taken in 2010 towards this goal. The Company's two kraft pulp mills in France were sold in May 2010 for 100 million euros. These two assets were not a good long-term fit for the Company. This transaction was also an important catalyst, allowing the Company to refinance its debt and reduce leverage. Another step taken to reposition Tembec was the permanent closure of the Pine Falls, Manitoba newsprint mill. The high-cost structure of the mill combined with the continued decline in North American demand led to this decision.

The Company is focused on positioning its assets in first or second quartiles on the cost curve for their respective sector. Asset sales and closures have removed facilities that did not have the potential to meet this objective. Cost reductions are being achieved in existing facilities through internal efforts and, in some cases, with the assistance of external expertise. The Company has also established a Business Improvement Plan that will target capital investments in mills to further improve their competitive cost position. A number of these projects are energy related.

BUSINESS OUTLOOK

Forest Products

The North American lumber industry continued to be adversely affected by the weak housing market in the United States. While housing starts did improve modestly over 2009, the home construction industry continued to suffer from relatively poor economic conditions in the U.S. and the overhang of foreclosed properties on the market. The Company continues to forecast a slow recovery in U.S. housing starts and believes it will likely take another two to three years until normalized conditions return.

Despite the continued poor U.S. housing starts in 2010, market conditions did improve for North American lumber producers. Unprecedented Chinese demand for softwood lumber has created new market opportunities for producers to sell product offshore, which kept the North American markets relatively balanced. The increasing Chinese demand is expected to provide continued relief for lumber producers until more normalized housing market conditions return to the United States.

Higher year over year selling prices and cost reduction initiatives combined to improve the financial results of the Company's Forest Products Group. However, the results remained unacceptable. While further improvement is expected in fiscal 2011, the Forest Products business is not expected to be a material contributor of EBITDA.

Paper Pulp

The Company's paper pulp business benefited from a demand and price recovery that began in mid-2009 and carried over into 2010. High operating rates and low producer inventories created very favourable conditions for producers, allowing for successive month over month price increases for the first five calendar months in 2010. The tight supply conditions were further exacerbated by a massive earthquake in Chile that idled approximately 7% of the global market pulp capacity.

Additional paper pulp supply hit the market in the second half of 2010 through the combination of a new mill start-up and the reopening of some shutdown capacity. When combined with a reduction in demand from China, this created conditions for prices to decline, with the drop being much more significant for high-yield pulps than kraft pulps. The high value of the Canadian, European and Brazilian currencies versus the US dollar continues to put pressure on producers from these regions to maintain higher US $ reference prices for pulp.

The fundamentals for paper pulp supply/demand appear favourable for the next two to three years due to the lack of expected capacity additions during this period. Pulp demand will continue to be driven by global economic growth and the growing need for paper and hygiene products in the emerging markets. Therefore, the Company's Pulp Group should benefit from favourable conditions during this period.

Specialty and Commodity Dissolving Pulp

Demand for dissolving pulps had been declining up to the year 2000, leading to unfavourable conditions for producers and resulting in the shutdown of many dissolving pulp mills. This trend has since changed due to significant growth in demand from the emerging markets and reduced availability of competing materials. Robust demand growth for commodity dissolving pulp and steady growth for specialty dissolving pulps combined to create very favourable conditions for producers in 2010.

The commodity dissolving pulp prices have recently hit record highs on the spot market due to a shortage of this product. This was underpinned by good demand fundamentals and a poor global cotton crop. Given the ability of specialty dissolving pulp producers to also produce commodity grades and the growth in demand for the specialty grades, conditions in 2010 saw substantial price increases where supply contracts allowed. Many of these contracts have pricing provisions renewed annually in January of each year and it is expected that there will be an average of US $200 per tonne increase in dissolving pulp prices beginning in early 2011.

The mid to long-term fundamentals look positive for both specialty and commodity dissolving pulps. It is likely that this will drive investments in additional commodity dissolving pulp capacity, which could come from the conversion of existing or idle kraft pulp capacity. The barriers to entry are much greater for specialty dissolving pulp production where there are considerable capital, technical and commercial hurdles which limit capacity additions.

Paper

The Company competes in the coated bleached board and newsprint sectors. The Paper Group generated negative EBITDA in 2010 due entirely to the poor results of the newsprint business. The group results returned to a positive EBITDA by the fourth quarter of fiscal 2010 due to the profitability of the coated bleached board business and moderating losses from the newsprint business. The Pine Falls newsprint facility did not operate in fiscal 2010, but the Company did incur substantial custodial costs. The recently announced permanent closure will lead to reduced costs and a more modest impact on future results.

The North American coated bleached board market conditions were favorable for producers in 2010 due to solid demand and high operating rates. These conditions allowed prices to increase throughout the year. Also contributing to these market conditions was the ruling by the U.S. government on anti-dumping charges against certain Asian producers, which virtually eliminated this source of product into the North American markets. It is expected that the North American market conditions, that were favourable for producers in 2010, will continue into at least the first half of 2011 maintaining high operating rates and supporting the current pricing levels. The Company's coated bleached board operation should generate relatively good levels of profitability.

The North American newsprint industry has suffered from multi-year declines in demand in the North American markets due to significant shifts in consumption patterns and the growing use of internet technology. Despite aggressive reductions in supply due to capacity closures, the markets became significantly oversupplied in 2009 and this carried over into the early part of 2010. The rate of demand reduction in the North American markets decelerated in 2010, while global demand continued to grow. This created offshore opportunities for the North American producers. These conditions led to a balanced North American market in mid-2010 where producers' inventories had dropped and prices had increased. It is expected that the relatively favourable market conditions will continue for North American newsprint in the first half of 2011 and additional price increases are likely. The Company anticipates that the newsprint operation will return to profitability in 2011. When combined with solid returns in the coated bleached board sector, it is anticipated that the Company's Paper Group will be a material contributor of EBITDA in fiscal 2011.

Chemicals

The Chemical Products Group produces ethanol and lignosulfonates, which are by-products of the dissolving pulp process. The group also produces resin products used as an adhesive in a variety of applications. While demand and pricing for ethanol has been relatively stable, demand for lignosulfonates and resins continues to be affected by poor dynamics in the construction sector. As the economies slowly improve in North America and Europe, demand for these products is also expected to increase.

STRATEGY

Implementation of the Company's strategy has resulted in the realignment of the Company's portfolio of assets. The focus is now to reposition the manufacturing facilities to achieve a low cost position in the respective sectors where they compete. The Company's Business Improvement Plan will drive this repositioning, which includes capital expenditures to improve the competitive cost position of certain facilities. A large portion of these investments will be in green energy production or reductions in energy consumption and will take advantage of incentive programs targeting green energy production or energy conservation.

SUMMARY

While there are further opportunities for improvement, the Company is pleased with the financial results of fiscal 2010 and the progress made to reposition Tembec over the last year. Management and the Board of Directors will continue to work proactively to further develop the earnings potential of the Company. This will be done while maintaining Tembec's position as a leader in forest stewardship.

JAMES M. LOPEZ
President and Chief Executive Officer

James V Continenza

JAMES V. CONTINENZA
Chairman of the Board