Message to Shareholders

The global economic collapse in late 2008 carried over into the first half of 2009. Needless to say, this had a devastating effect on the demand for all forest products and resulted in significant declines in pricing and negative EBITDA margins for the Company's major commodities. Due to the very poor business climate and unacceptable financial results, the Company took unprecedented steps to reduce costs and working capital.

FOREST PRODUCTS

The lumber industry, already suffering from a poor U.S. housing market due to the sub-prime mortgage problems, experienced even more extensive reductions in demand and price as the recession and credit crisis devastated the home building industry. As housing starts dropped below a half million per year in the U.S., a significant repositioning was taking place in the supply chain. Distributors servicing the home builders consolidated lumber yards into fewer locations and virtually all customers downstream of the sawmills drastically reduced inventories to align with the outlook for new home construction. This overall inventory reduction and the actual decline in demand hit lumber producers hard in early 2009 and forced pricing into negative margin territory for virtually all companies.

Tembec significantly adjusted its lumber production in 2009 by balancing contribution margins with chip requirements and shutdown costs. Additionally, the Company has revised its approach to lumber sales by taking advantage of its superior quality versus the pine beetle product coming out of the North and Central Interior of British Columbia and by leveraging its FSC certification. These actions reduced the losses by the Forest Products Group by the end of the September 2009 quarter.

A very modest recovery in U.S. housing starts in 2010 is anticipated by most companies involved in the lumber business. For this reason, inventories of product remain very lean throughout the supply chain. The sawmill sector is operating significantly below capacity and log inventories and harvesting plans reflect these lower levels of production. The Company does not expect any significant improvement in 2010 as reflected in its plans. However, a surprise upside in demand would prove very challenging for the supply chain and given the lean inventories, could result in an unexpected improvement in price.

PULP

Throughout the first half of calendar 2008, the Company's paper pulp and specialty dissolving pulp business experienced relatively robust demand and a positive pricing environment. Precipitated by the credit crisis, this changed dramatically in the last three months of 2008. A deep global recession reduced downstream demand for the Company's pulp products, and the credit crisis forced all those in the supply chain to manage working capital aggressively and reduce inventories. This resulted in a record decline in the Company's order backlog and continued into the first half of 2009.

As a result of the collapse in pulp demand, global inventories rose to near record levels in the first half of calendar 2009 and prices declined to the point where most mills in the Northern Hemisphere had negative margins. During that period, we saw an unprecedented amount of temporary, indefinite and permanent downtime in pulp mills around the world. Tembec was no exception taking downtime in all pulp mills at some various points throughout that period. The result of the downtime by the pulp industry and destocking by downstream customers has led to low global inventories and a positive demand and pricing environment to start the Company's new fiscal year.

PAPER

The newsprint industry has been in a state of structural demand decline for its product since the start of the decade. The 2008/2009 recession exacerbated this structural decline by causing a cyclical decline. Despite significant capacity closure over the last several years and temporary curtailments, the newsprint market was over-supplied in 2009, leading to a price collapse in this sector and negative margins for most North American mills in the second half of the year. The Company took significant curtailments at both newsprint mills in response to these market conditions.

The Company was unable to successfully negotiate a new collective agreement at the Pine Falls newsprint facility which resulted in a lockout in September 2009. At this time, the Company is reviewing the future plans for this operation given the challenging outlook for this sector.

The Company's coated bleached paperboard mill performed very well in 2009. Despite the decline in demand for this product in North America, aggressive downtime by producers prevented the collapse in price as seen in our other sectors. The business also benefited from a decline in major input costs including pulp and chemicals. A balanced market is anticipated for this sector in 2010, but higher pulp prices will likely negatively impact costs.

CHEMICALS

The Chemical Products Group experienced a significant decline in demand for its products as a result of the recession, except for ethanol. The Group was profitable throughout the year despite the challenges and generated solid financial results. Significant strides were made to improve the margins in lignosulfonate and resin products despite a nearly 50% reduction in demand. The Group is well positioned for a recovery in demand.

COST REDUCTION

The extremely challenging business conditions and poor financial results in 2009 caused the Company to take aggressive action to reduce costs. Despite dramatic declines in SG&A expense over the last three years, additional reductions were made. Staff reductions were made at all levels and in all departments of the organization. Difficult decisions were also made to implement temporary staff layoffs at operations where curtailments occurred, and a staff salary freeze was implemented throughout the organization as well as changes to certain pension plans.

An aggressive cost reduction plan was implemented with the Company's suppliers and service providers to reduce prices by 10-20%. We were very pleased with the response of the majority of Tembec's suppliers. These reductions had a significant positive impact on SG&A and mill operating costs.

STRATEGIC REVIEW

The Company's Board of Directors has actively engaged management on a strategic review of Tembec's portfolio of businesses. The purpose of the process is to create a more profitable and focused Company which will generate greater returns for shareholders. The review will also result in certain actions which will allow the Company to maintain and enhance liquidity throughout this challenging period for the forest products industry. The Company is actively pursuing a number of strategic and liquidity enhancing projects. Periodic announcements will be forthcoming in this regard.

SUMMARY

The financial results for fiscal 2009 are unacceptable regardless of the economic circumstances. Aggressive measures are being implemented to ensure that the results for 2010 will be vastly improved. While a more positive economic environment will contribute to this improvement, the Company will focus on those things it can control both operationally and strategically to produce better financial results.

JAMES M. LOPEZ
President and Chief Executive Officer