tembec

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Second Quarter Report 2017

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REPORT TO THE SHAREHOLDERS

Second Quarter Fiscal 2017

Consolidated sales for the three-month period ended March 25, 2017, were $387 million, as compared to $380 million in the same quarter a year ago. The Company generated net earnings of $24 million or $0.24 per share in the March 2017 quarter compared to net earnings of $27 million or $0.27 per share in the March 2016 quarter. The prior year quarter included a non-cash gain of $27 million related to the translation of US dollar denominated debt. The March 2017 quarter includes a non-cash debt translation gain of $7 million. Operating earnings before depreciation, amortization and other items (adjusted EBITDA) was $54 million for the three-month period ended March 25, 2017, as compared to adjusted EBITDA of $36 million a year ago and adjusted EBITDA of $34 million in the prior quarter.

Business Segment Results

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $28 million on sales of $120 million for the quarter ended March 25, 2017, compared to adjusted EBITDA of $10 million on sales of $103 million in the December 2016 quarter. The pulp sales increase of $15 million was due to higher shipments. Canadian dollar selling prices for specialty grades improved by $7 per tonne. While euro prices for specialty pulp at the Tartas mill increased by approximately 6%, this was largely offset by a weaker euro and a lower value sales mix at the Temiscaming pulp mill. Overall, Canadian dollar selling prices were relatively unchanged quarter-over-quarter. The $43 per tonne increase in the selling price of viscose and other grades was due to higher US dollar selling prices. Shipments were equal to 86% of capacity, compared to 73% in the December 2016 quarter. During the December 2016 quarter, the Tartas specialty cellulose pulp mill was idled for 11 days due to its major maintenance outage. These occur at 18 month intervals. The Temiscaming specialty cellulose pulp mill also incurred a two-day planned maintenance outage. There were no major maintenance outages in the March 2017 quarter. As a result, the two pulp mills produced 14,600 more tonnes in the March 2017 quarter. Manufacturing costs decreased by $17 million quarter-over-quarter, including $5 million for maintenance material and $10 million of fixed costs absorption associated with the aforementioned productivity increase. Chemical business adjusted EBITDA increased by $1 million.

The Forest Products segment generated adjusted EBITDA of $10 million on sales of $110 million for the quarter ended March 25, 2017, compared to adjusted EBITDA of $9 million on sales of $113 million in the prior quarter. SPF lumber sales decreased by $3 million due to lower shipments, partially offset by higher prices. During the March 2017 quarter, the random length lumber reference price increased by US $23 per mbf while the reference price for stud lumber increased by US $33 per mbf. Currency was not a significant factor as the Canadian dollar averaged US $0.755, a 0.5% increase from US $0.751 in the prior quarter. The combined effect was that Canadian dollar selling prices increased by $28 per mbf, increasing adjusted EBITDA by $5 million. Lumber shipments were equal to 87% of capacity, as compared to 95% in the prior quarter. The cash cost of SPF lumber increased by $3 million, primarily for purchased fibre.

The Paper Pulp segment generated adjusted EBITDA of $9 million on sales of $85 million in the March 2017 quarter, compared to adjusted EBITDA of $7 million on sales of $83 million in the December 2016 quarter. The $2 million increase in sales was due to higher selling prices and shipments. The benchmark price (delivered China) for bleached eucalyptus kraft (BEK) increased by US $77 per tonne. US dollar prices for high-yield pulp followed a similar but less pronounced trend, increasing by US $10 per tonne quarter-over-quarter. Overall, average selling prices for external sales in Canadian dollars increased by $11 per tonne, increasing adjusted EBITDA by $1 million. Pulp shipments were equal to 95% of capacity in both quarters. The two pulp mills produced 6,800 more tonnes than in the prior quarter and manufacturing costs were relatively unchanged.

The Paper segment generated adjusted EBITDA of $16 million on sales of $96 million for the quarter ended March 25, 2017, compared to adjusted EBITDA of $17 million on sales of $96 million in the December 2016 quarter. There were no significant changes to shipments or prices quarter-over-quarter. The US dollar reference price for coated bleached board was unchanged quarter-over-quarter. Overall, average selling prices for coated bleached board were down $22 per tonne decreasing adjusted EBITDA by $1 million. The coated bleached board shipment to capacity ratio was 106% compared to 101% in the prior quarter. Manufacturing costs increased by $2 million. The US dollar benchmark price for newsprint was unchanged quarter-over-quarter. The newsprint mill experienced a less favourable sales mix and US dollar prices declined by US $8 per tonne. Overall, average selling prices for newsprint decreased by $14 per tonne, reducing adjusted EBITDA by $1 million. The newsprint shipment to capacity ratio was 79% compared to 82% in the prior quarter. Costs increased by $2 million, primarily for electrical energy.

<u>Lumber Duty Deposits</u>

On April 24, 2017, the U.S. Department of Commerce (USDOC) announced its preliminary determination on countervailing duties (CVD) and imposed a preliminary duty rate of 19.88% on the Company's shipments of lumber into the U.S. The Company as well as other Canadian lumber producers and the Federal and Provincial governments strongly disagree with the preliminary determination made by the USDOC. The Company intends to aggressively defend its position on this matter. More details are provided in the Subsequent Event section of the Company's March 2017 quarterly filings.

<u>Outlook</u>

Overall, the March 2017 quarterly results exceeded expectations as all four business segments generated operating earnings ahead of forecast. Currency was not a significant factor as the Canadian dollar averaged 0.5% higher versus the US dollar in the March 2017 quarter.

The $18 million increase in adjusted EBITDA for the Specialty Cellulose segment was largely expected. The combination of reduced maintenance, higher productivity and higher prices for certain specialty grades and viscose grades were all contributing factors that increased adjusted EBITDA margins beyond 25% for the quarter. While the Company anticipates continued strong results from this line of business, the June 2017 financial results will be impacted by the planned major maintenance outage at the Temiscaming mill in the month of May. Lumber markets continued to perform well and prices increased quarter-over-quarter. The recently announced CVD preliminary determination will impact the Company's financial results and liquidity in future periods. A preliminary determination on antidumping duties (ADD) is expected in the June quarter. The Company anticipates that a portion of the CVD and ADD will be passed on to customers in the form of higher lumber prices. The implementation of CVD and ADD deposits will likely lead to more volatility as Canadian producers adapt to the changing circumstances. The Paper Pulp segment results continue to exceed expectations. Anticipated new BEK pulp capacity has been ramping up at a slower pace than initially expected. However, this new capacity will eventually occur, putting pressure on the hardwood pulp market. The Paper segment generated adjusted EBITDA of $16 million, which represents another solid quarter for the segment and it should continue to perform well. The coated bleached board market is well balanced leading to continued pricing stability. The newsprint market continues to experience declining demand and will require further capacity reduction to maintain a balanced market.

With trailing twelve-month adjusted EBITDA of $171 million, including $8 million of share-based compensation expense, the Company continued to demonstrate the positive impact on margins of the Temiscaming cogeneration project as well as other cost reduction and productivity initiatives. The Company will continue to focus on controllable items such as cost and working capital items with a goal of further improving operating margins. While the CVD and ADD deposits will impact future cash flow, the Company's relatively high liquidity combined with anticipated improving margins have put it in a good position to continue to reduce its level of indebtedness and proceed with cost reducing capital expenditures.

James Lopez
President & C.E.O.

Management’s Discussion and Analysis
for the quarter ended March 25, 2017

The following interim Management Discussion and Analysis (MD&A) provides a review of the significant developments and issues that impacted Tembec’s financial performance during its second fiscal quarter ended March 25, 2017. The MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the period ended March 25, 2017, and the audited consolidated financial statements and annual MD&A for the fiscal year ended September 24, 2016, included in the Company’s Financial Report. Financial data has been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). All financial references are stated in Canadian dollars, unless otherwise noted. All references to quarterly information relate to Tembec’s fiscal quarters. Adjusted EBITDA, net debt to total capitalization, free cash flow and certain other financial measures utilized in the MD&A are non-IFRS financial measures. As they have no standardized meaning prescribed by IFRS, they may not be comparable to similar measures presented by other companies. Non-IFRS financial measures are described in the Definitions section of the MD&A.

The interim MD&A includes “forward-looking statements” within the meaning of securities laws. Such statements relate, without limitation, to the Company’s or management’s objectives, projections, estimates, expectations or predictions of the future and can be identified by words such as “may”, “will”, “could”, “anticipate”, “estimate”, “expect” and “project”, the negative or variations thereof, and expressions of similar nature. Forward-looking statements are based on certain assumptions and analyses made by the Company in light of its experience, information available to it and its perception of future developments. Such statements are subject to a number of risks and uncertainties, including, but not limited to, changes in foreign exchange rates, product selling prices, raw material and operating costs and other factors identified in the Company’s periodic filings with securities regulatory authorities, including under the “risk factors” section of the Company’s most recent Annual Information Form. Many of these risks are beyond the control of the Company and, therefore, may cause actual actions or results to materially differ from those expressed or implied herein. The forward-looking statements contained herein reflect the Company’s expectations as of the date hereof and are subject to change after such date. The Company disclaims any intention to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by applicable securities legislation. The information in the MD&A is as at May 2, 2017, the date of filing in conjunction with the Company’s press release announcing its results for the second fiscal quarter of 2017. Disclosure contained in this document is current to that date, unless otherwise stated.

CONSOLIDATED RESULTS

Quarterly Results ($ millions)

	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Sales	354	380	376	389	370	**387**	-	-
Freight and other deductions	47	49	49	48	46	**47**	-	-
Cost of sales	264	279	284	270	270	**266**	-	-
SG&A	15	16	16	15	16	**16**	-	-
Share-based compensation	(1)	-	1	(1)	4	**4**	-	-
Adjusted EBITDA	29	36	26	57	34	**54**	-	-
Depreciation and amortization	12	13	13	15	12	**13**	-	-
Other items	1	-	(5)	-	1	**-**	-	-
Operating earnings	16	23	18	42	21	**41**	-	-
Interest, foreign exchange and other	17	22	18	18	16	**20**	-	-
Foreign exchange loss (gain) on long-term debt	24	(27)	(11)	8	16	**(7)**	-	-
Earnings (loss) before income taxes	(25)	28	11	16	(11)	**28**	-	-
Income tax expense (recovery)	3	1	2	4	(2)	**4**	-	-
Net earnings (loss)	(28)	27	9	12	(9)	**24**	-	-

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

CONSOLIDATED SUMMARY

SALES

$ millions	December 2016	**March 2017**	Total Variance	Price Variance	Volume & Mix Variance
Forest Products	113	**110**	(3)	4	(7)
Specialty Cellulose Pulp	103	**120**	17	1	16
Paper Pulp	83	**85**	2	1	1
Paper	96	**96**	-	(2)	2
Corporate	1	**1**	-	-	-
	396	**412**	16	4	12
Less: Intersegment Sales	(26)	**(25)**	1		
Sales	370	**387**	17		

Sales increased by $17 million as compared to the prior quarter. Currency was not a significant factor as the Canadian dollar averaged US $0.755, a 0.5% increase from US $0.751 in the prior quarter. Forest Products segment sales decreased by $3 million due to lower shipments, partially offset by higher lumber prices. Specialty Cellulose Pulp segment sales increased by $17 million due primarily to higher shipments. Paper Pulp segment sales increased by $2 million due to higher prices and shipments. Paper segment sales were unchanged, with increased shipments offsetting lower prices.

ADJUSTED EBITDA

$ millions	December 2016	**March 2017**	Total Variance	Price Variance	Cost & Volume Variance
Forest Products	9	**10**	1	4	(3)
Specialty Cellulose Pulp	10	**28**	18	1	17
Paper Pulp	7	**9**	2	1	1
Paper	17	**16**	(1)	(2)	1
Corporate	(9)	**(9)**	-	-	-
	34	**54**	20	4	16

Adjusted EBITDA increased by $20 million as compared to the prior quarter. The Forest Products segment adjusted EBITDA increased by $1 million as a result of higher prices, partially offset by higher costs. Specialty Cellulose Pulp segment adjusted EBITDA increased by $18 million due primarily to lower costs. Paper Pulp segment adjusted EBITDA was up $2 million due to lower costs and higher selling prices. Paper segment adjusted EBITDA decreased by $1 million due to lower prices, partially offset by lower costs. Corporate costs include $4 million of share-based compensation expense in both quarters.

OPERATING EARNINGS (LOSS)

$ millions	December 2016	**March 2017**	Total Variance	Adjusted EBITDA Variance	Depreciation Variance	Other Items Variance
Forest Products	8	**8**	-	1	(1)	-
Specialty Cellulose Pulp	3	**21**	18	18	-	-
Paper Pulp	4	**6**	2	2	-	-
Paper	16	**15**	(1)	(1)	-	-
Corporate	(10)	**(9)**	1	-	-	1
	21	**41**	20	20	(1)	1

The Company generated operating earnings of $41 million compared to operating earnings of $21 million in the prior quarter. The previously noted increase in adjusted EBITDA led to the improvement in operating results. A more detailed explanation of segment variances is included in the analysis that follows.

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

SEGMENT RESULTS – FOREST PRODUCTS

	December 2016	**March 2017**	Variance
Financial ($ millions)			
Sales - SPF Lumber	83	**80**	(3)
Sales - Chips, logs and other(1)	30	**30**	-
	113	**110**	(3)
Freight and other deductions	11	**11**	-
Cost of sales	90	**86**	4
SG&A	3	**3**	-
Adjusted EBITDA	9	**10**	1
Depreciation and amortization	1	**2**	(1)
Operating earnings	8	**8**	-
Shipments			
SPF (spruce/pine/fir) lumber (mmbf)	179	**163**	(16)
Benchmark Prices			
KD #2 & better delivered G.L. (US $ per mbf)	403	**426**	23
KD stud delivered G.L. (US $ per mbf)	360	**393**	33

(1) Includes intersegment sales eliminated on consolidation

The Forest Products segment generated adjusted EBITDA of $10 million on sales of $110 million for the quarter ended March 25, 2017, compared to adjusted EBITDA of $9 million on sales of $113 million in the prior quarter. SPF lumber sales decreased by $3 million due to lower shipments, partially offset by higher prices.

During the March 2017 quarter, the random length lumber reference price increased by US $23 per mbf while the reference price for stud lumber increased by US $33 per mbf. Currency was not a significant factor as the Canadian dollar averaged US $0.755, a 0.5% increase from US $0.751 in the prior quarter. The combined effect was that Canadian dollar selling prices increased by $28 per mbf, increasing adjusted EBITDA by $5 million. Lumber shipments were equal to 87% of capacity, as compared to 95% in the prior quarter. The cash cost of SPF lumber increased by $3 million, primarily for purchased fibre.

The Forest Products segment generated operating earnings of $8 million, unchanged from the prior quarter. The increase in adjusted EBITDA was offset by an increase in depreciation and amortization expense.

On October 31, 2016, the Company completed the sale of the Senneterre, Quebec, sawmill and related forestry assets for $8 million. This included certain working capital items totalling approximately $5 million. The assets were sold at their carrying values.

On November 25, 2016, the U.S. Lumber Coalition filed a petition with the U.S. Department of Commerce (USDOC) and the U.S. International Trade Commission (USITC) to impose duties on imports of Canadian softwood lumber to the U.S. On December 15, 2016, the USDOC agreed to conduct countervailing duty (CVD) and antidumping duty (ADD) investigations of Canadian softwood lumber exports to the U.S. The preliminary CVD determination was announced on April 24, 2017, and imposed a preliminary duty rate of 19.88% (see Subsequent Event).

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

SEGMENT RESULTS – SPECIALTY CELLULOSE PULP

	December 2016	**March 2017**	Variance
Financial ($ millions)			
Sales - Pulp	84	**99**	15
Sales - Chemicals	19	**21**	2
	103	**120**	17
Freight and other deductions	9	**10**	(1)
Cost of sales	80	**78**	2
SG&A	4	**4**	-
Adjusted EBITDA	10	**28**	18
Depreciation and amortization	7	**7**	-
Operating earnings	3	**21**	18
Pulp shipments			
Specialty grades (000's tonnes)	46	**51**	5
Viscose and other grades (000's tonnes)	10	**16**	6
	56	**67**	11
Average prices			
Specialty grades (C $ per tonne)	1,528	**1,535**	7
Viscose and other grades (C $ per tonne)	1,285	**1,328**	43

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $28 million on sales of $120 million for the quarter ended March 25, 2017, compared to adjusted EBITDA of $10 million on sales of $103 million in the December 2016 quarter. The pulp sales increase of $15 million was due to higher shipments.

Canadian dollar selling prices for specialty grades improved by $7 per tonne. While euro prices for specialty pulp at the Tartas mill increased by approximately 6%, this was largely offset by a weaker euro and a lower value sales mix at the Temiscaming pulp mill. Overall, Canadian dollar selling prices were relatively unchanged quarter-over-quarter. The $43 per tonne increase in the selling price of viscose and other grades was due to higher US dollar selling prices. Shipments were equal to 86% of capacity, compared to 73% in the December 2016 quarter. During the December 2016 quarter, the Tartas specialty cellulose pulp mill was idled for 11 days due to its major maintenance outage. These occur at 18 month intervals. The Temiscaming specialty cellulose pulp mill also incurred a two-day planned maintenance outage. There were no major maintenance outages in the March 2017 quarter. As a result, the two pulp mills produced 14,600 more tonnes in the March 2017 quarter. Manufacturing costs decreased by $17 million quarter-over-quarter, including $5 million for maintenance material and $10 million of fixed costs absorption associated with the aforementioned productivity increase. Chemical business adjusted EBITDA increased by $1 million. Finished goods inventories of specialty cellulose pulp were at approximately 34 days of supply at the end of March 2017, compared to 30 days at the end of the prior quarter.

The Specialty Cellulose Pulp segment generated operating earnings of $21 million, compared to operating earnings of $3 million in the December 2016 quarter. The previously noted increase in adjusted EBITDA led to the improvement in operating results.

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

SEGMENT RESULTS – PAPER PULP

	December 2016	**March 2017**	Variance
Financial ($ millions)			
Sales [(1)]	83	**85**	2
Freight and other deductions	16	**16**	-
Cost of sales	59	**58**	1
SG&A	1	**2**	(1)
Adjusted EBITDA	7	**9**	2
Depreciation and amortization	3	**3**	-
Operating earnings	4	**6**	2
Shipments			
High-yield pulp (000's tonnes)	120	**121**	1
Internal (000's tonnes)	15	**15**	-
Total	135	**136**	1
Benchmark Prices			
BEK - delivered China (US $ per tonne)	513	**590**	77

(1) Includes intersegment sales eliminated on consolidation

The Paper Pulp segment generated adjusted EBITDA of $9 million on sales of $85 million in the March 2017 quarter, compared to adjusted EBITDA of $7 million on sales of $83 million in the December 2016 quarter. The $2 million increase in sales was due to higher selling prices and shipments.

The benchmark price (delivered China) for bleached eucalyptus kraft (BEK) increased by US $77 per tonne. US dollar prices for high-yield pulp followed a similar but less pronounced trend, increasing by US $10 per tonne quarter-over-quarter. Currency was not a significant factor as the Canadian dollar averaged US $0.755, a 0.5% increase from US $0.751 in the prior quarter. Overall, average selling prices for external sales in Canadian dollars increased by $11 per tonne, increasing adjusted EBITDA by $1 million. Pulp shipments were equal to 95% of capacity in both quarters. The two pulp mills produced 6,800 more tonnes than in the prior quarter and manufacturing costs were relatively unchanged. Paper pulp inventories were at 24 days of supply at the end of March 2017 quarter, as compared to 22 days at the end of December 2016 quarter.

The Paper Pulp segment generated operating earnings of $6 million in the March 2017 quarter, compared to operating earnings of $4 million in the prior quarter. The increase in adjusted EBITDA led to the improvement in operating results.

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

SEGMENT RESULTS – PAPER

	December 2016	**March 2017**	Variance
Financial ($ millions)			
Sales	96	**96**	-
Freight and other deductions	10	**10**	-
Cost of sales	66	**68**	(2)
SG&A	3	**2**	1
Adjusted EBITDA	17	**16**	(1)
Depreciation and amortization	1	**1**	-
Operating earnings	16	**15**	(1)
Shipments			
Coated bleached board (000's tonnes)	46	**48**	2
Newsprint (000's tonnes)	45	**43**	(2)
Total	91	**91**	-
Benchmark Prices			
16 pt. Coated bleached board (US $ per short ton)	1,010	**1,010**	-
Newsprint - 48.8 gram East Coast (US $ per tonne)	575	**575**	-

The Paper segment generated adjusted EBITDA of $16 million on sales of $96 million for the quarter ended March 25, 2017, compared to adjusted EBITDA of $17 million on sales of $96 million in the December 2016 quarter. There were no significant changes to shipments or prices quarter-over-quarter.

The US dollar reference price for coated bleached board was unchanged quarter-over-quarter. Currency was not a significant factor as the Canadian dollar averaged US $0.755, a 0.5% increase from US $0.751 in the prior quarter. Overall, average selling prices for coated bleached board were down $22 per tonne decreasing adjusted EBITDA by $1 million. The coated bleached board shipment to capacity ratio was 106% compared to 101% in the prior quarter. Manufacturing costs increased by $2 million. Finished goods inventories of coated bleached board were at approximately 51 days of supply at the end of the March 2017 quarter, compared to 56 days at the end of the December 2016 quarter.

The US dollar benchmark price for newsprint was unchanged quarter-over-quarter. The newsprint mill experienced a less favourable sales mix and US dollar prices declined by US $8 per tonne. Overall, average selling prices for newsprint decreased by $14 per tonne, reducing adjusted EBITDA by $1 million. The newsprint shipment to capacity ratio was 79% compared to 82% in the prior quarter. Costs increased by $2 million, primarily for electrical energy. Finished goods inventories of newsprint were at approximately 26 days of supply at the end of the March 2017 quarter, compared to 19 days at the end of the December 2016 quarter.

The Paper segment generated operating earnings of $15 million, compared to operating earnings of $16 million in the December 2016 quarter. The previously noted decrease in adjusted EBITDA led to the lower operating profitability.

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

SEGMENT RESULTS – CORPORATE

	December 2016	**March 2017**
Financial ($ millions)		
General and administrative expenses	5	**5**
Share-based compensation	4	**4**
Other items:		
Custodial - idled facilities	1	**-**
Operating loss	10	**9**

The Company recorded a $4 million expense for share-based compensation in the March 2017 quarter, unchanged from the prior quarter. Senior executives currently participate in a long-term incentive plan which entitles participants to potentially receive units that are equal in value to one common share. The units have a defined vesting period and certain units are subject to specific conditions that ultimately determine the number of units that vest and are earned by plan participants. Non-executive members of the board of directors receive a portion of their fees in the form of "Deferred Share Units" (DSU). The DSUs vest at specified dates. The fair value of the obligation related to DSUs is estimated at each balance sheet date and a corporate expense or credit is recorded.

The Corporate segment's "other items" include expenses relating to several permanently idled facilities. The costs relate to custodial, site security, legal, pension plan administration and remediation activities. These "legacy" items totalled $1 million in the December 2016 quarter as compared to a negligible amount in the March 2017 quarter.

INTEREST, FOREIGN EXCHANGE AND OTHER

The following table summarizes interest, foreign exchange and other expenses by component:

	$ millions	
	December 2016	**March 2017**
Interest on debt	15	**15**
Amortization of financing costs	2	**1**
Foreign exchange items	(3)	**2**
Employee future benefits	1	**1**
Bank charges and other	1	**1**
	16	**20**

The interest expense relates primarily to interest on the US $375 million – 9% senior secured notes maturing in December 2019. Financing costs are amortized over the remaining term of each respective credit facility. Foreign exchange items are primarily caused by gains or losses on the translation of US dollar net monetary assets. The charge for employee future benefits relates to interest accretion on net unfunded obligations.

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

TRANSLATION OF FOREIGN DEBT

During the March 2017 quarter, the Company recorded a gain of $7 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar increased from US $0.739 to US $0.748.

During the December 2016 quarter, the Company recorded a loss of $16 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.759 to US $0.739.

INCOME TAXES

The following table reconciles the anticipated income tax expense (recovery) based on the statutory rate to the actual income tax expense (recovery):

	$ millions	
	December 2016	**March 2017**
Earnings (loss) before income taxes	(11)	**28**
Anticipated income tax expense (recovery)	(3)	**7**
Recognition of previously unrecognized tax assets	(5)	**(4)**
Decrease in income tax rates	5	**-**
Non-deductible (non-taxable) portion of foreign exchange loss (gain) on long-term debt	2	**(1)**
Permanent differences and other tax adjustments	(1)	**2**
Income tax expense (recovery)	(2)	**4**

During the March 2017 quarter, the Company recorded an income tax expense of $4 million on earnings before income taxes of $28 million. The income tax expense reflected a $3 million favourable variance versus an anticipated income tax expense of $7 million based on the Company's effective tax rate of 26.1%. The income tax expense decreased by $4 million as a result of the recognition of previously unrecognized tax assets. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. The non-taxable portion of the foreign exchange gain on translation of debt decreased the income tax expense by $1 million. Permanent differences and other tax adjustments increased the income tax expense by $2 million.

During the December 2016 quarter, the Company recorded an income tax recovery of $2 million on a loss before income taxes of $11 million. The income tax recovery reflected a $1 million unfavourable variance versus an anticipated income tax recovery of $3 million based on the Company's effective tax rate of 26.1%. The income tax recovery increased by $5 million as a result of the recognition of previously unrecognized tax assets. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. Lower income tax rates decreased the income tax recovery by $5 million. The non-deductible portion of the foreign exchange loss on translation of debt decreased the income tax recovery by $2 million. Permanent differences and other tax adjustments increased the income tax recovery by $1 million.

MARCH 2017 QUARTER VS DECEMBER 2016 QUARTER

NET EARNINGS (LOSS)

The Company generated net earnings of $24 million or $0.24 per share for the quarter ended March 25, 2017. This compares to a net loss of $9 million or $0.09 per share for the quarter ended December 24, 2016.

COMPREHENSIVE EARNINGS

The following table summarizes the impact of items affecting the reported total comprehensive earnings during the last two quarters:

	$ millions	
	December 2016	**March 2017**
Net earnings (loss)	(9)	**24**
Employee future benefit gain	50	**4**
Income tax expense	(2)	**-**
Foreign currency translation gain (loss) on foreign operations	(10)	**5**
Total comprehensive earnings	29	**33**

During the March 2017 quarter, the Company recognized a gain of $4 million relating to the decrease of the estimated net obligation for employee future benefits. The return on plan assets was more than the expected return, decreasing the net obligation by $23 million. The average discount rate applied to estimate the present value of future obligations decreased from 3.84% to 3.67%, thereby increasing the net obligation by $19 million.

During the December 2016 quarter, the Company recognized a gain of $50 million relating to the decrease of the estimated net obligation for employee future benefits. The return on plan assets was less than the expected return, increasing the net obligation by $20 million. The average discount rate applied to estimate the present value of future obligations increased from 3.24% to 3.84%, thereby decreasing the net obligation by $67 million. Due to the absence of current service costs in certain legacy pension plans, the Company is limited in its ability to recognize all plan assets held in trust. The recognition of previously unrecognized assets reduced the net obligation by $1 million. Changes to demographic assumptions reduced the net obligation by $2 million. The Company recorded an income tax expense of $2 million related to the aforementioned gain of $50 million.

Comprehensive items include gains or losses related to the currency translation of the assets and liabilities of the Company's French and U.S. operations. The gains or losses are generated by changes in the end of period exchange rates. During the March 2017 quarter, the currency translation of the French operations generated a gain of $5 million. The currency translation of the U.S. operations did not generate a gain or a loss. During the December 2016 quarter, the currency translation of the French operations generated a loss of $10 million. The currency translation of the U.S. operations did not generate a gain or a loss.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

CONSOLIDATED SUMMARY

SALES

$ millions	March 2016	**March 2017**	Total Variance	Price Variance	Volume & Mix Variance
Forest Products	108	**110**	2	11	(9)
Specialty Cellulose Pulp	120	**120**	-	3	(3)
Paper Pulp	77	**85**	8	6	2
Paper	102	**96**	(6)	(6)	-
Corporate	1	**1**	-	-	-
	408	**412**	4	14	(10)
Less: Intersegment Sales	(28)	**(25)**	3		
Sales	380	**387**	7		

Sales increased by $7 million from the same quarter a year ago. Currency was a negative factor as the Canadian dollar averaged US $0.755, a 3.9% increase versus US $0.727 in the comparable quarter of the prior year. Forest Products segment sales increased by $2 million as a result of higher lumber prices, partially offset by lower lumber shipments. Specialty Cellulose Pulp segment sales were flat, with higher prices offsetting lower shipments. Paper Pulp segment sales increased by $8 million due to higher prices and shipments. Paper segment sales decreased by $6 million due to lower prices.

ADJUSTED EBITDA

$ millions	March 2016	**March 2017**	Total Variance	Price Variance	Cost & Volume Variance
Forest Products	1	**10**	9	11	(2)
Specialty Cellulose Pulp	17	**28**	11	3	8
Paper Pulp	2	**9**	7	6	1
Paper	21	**16**	(5)	(6)	1
Corporate	(5)	**(9)**	(4)	-	(4)
	36	**54**	18	14	4

Adjusted EBITDA increased by $18 million from the prior year quarter. Forest Products segment adjusted EBITDA increased by $9 million due to higher prices. Specialty Cellulose Pulp segment adjusted EBITDA increased by $11 million due to lower costs and higher prices. Paper Pulp segment adjusted EBITDA increased by $7 million due to higher prices. Paper segment adjusted EBITDA decreased by $5 million due to lower prices. Corporate costs increased by $4 million due to share-based compensation expense.

OPERATING EARNINGS (LOSS)

$ millions	March 2016	**March 2017**	Total Variance	Adjusted EBITDA Variance	Depreciation Variance	Other Items Variance
Forest Products	(1)	**8**	9	9	-	-
Specialty Cellulose Pulp	10	**21**	11	11	-	-
Paper Pulp	(1)	**6**	7	7	-	-
Paper	20	**15**	(5)	(5)	-	-
Corporate	(5)	**(9)**	(4)	(4)	-	-
	23	**41**	18	18	-	-

The Company generated operating earnings of $41 million compared to operating earnings of $23 million in the same quarter a year ago. The previously noted improvement in adjusted EBITDA led to the improvement in operating results. A more detailed explanation of segment variances is included in the analysis that follows.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

SEGMENT RESULTS – FOREST PRODUCTS

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales - SPF Lumber	74	**80**	6
Sales - Chips, logs and other(1)	34	**30**	(4)
	108	**110**	2
Freight and other deductions	10	**11**	(1)
Cost of sales	94	**86**	8
SG&A	3	**3**	-
Adjusted EBITDA	1	**10**	9
Depreciation and amortization	2	**2**	-
Operating earnings (loss)	(1)	**8**	9
Shipments			
SPF lumber (mmbf)	173	**163**	(10)
Benchmark Prices			
KD #2 & better delivered G.L. (US $ per mbf)	365	**426**	61
KD stud delivered G.L. (US $ per mbf)	294	**393**	99

(1) Includes intersegment sales eliminated on consolidation

The Forest Products segment generated adjusted EBITDA of $10 million on sales of $110 million. This compares to adjusted EBITDA of $1 million on sales of $108 million in the comparable quarter of the prior year. The $6 million increase in SPF lumber sales was due to higher lumber prices, partially offset by lower shipments.

The US dollar benchmark price for random lumber increased by US $61 per mbf while the benchmark price for stud lumber was up US $99 per mbf. Currency partially mitigated the impact of these higher prices as the Canadian dollar averaged US $0.755, a 3.9% increase versus US $0.727 in the year ago quarter. Overall, Canadian dollar selling prices increased by $66 per mbf, increasing adjusted EBITDA by $11 million. Lumber shipments were equal to 87% of capacity, compared to 81% in the year ago quarter. The March 2016 quarter capacity included the Senneterre sawmill. The current quarter does not include the capacity of the Senneterre sawmill. The cash cost of SPF lumber increased by $3 million, primarily for purchased fibre.

The Forest Products segment generated operating earnings of $8 million, as compared to an operating loss of $1 million in the prior year quarter. The previously noted increase in adjusted EBITDA led to the improvement in operating results.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

SEGMENT RESULTS – SPECIALTY CELLULOSE PULP

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales - Pulp	100	**99**	(1)
Sales - Chemicals	20	**21**	1
	120	**120**	-
Freight and other deductions	11	**10**	1
Cost of sales	88	**78**	10
SG&A	4	**4**	-
Adjusted EBITDA	17	**28**	11
Depreciation and amortization	7	**7**	-
Operating earnings	10	**21**	11
Pulp shipments			
Specialty grades (000's tonnes)	43	**51**	8
Viscose and other grades (000's tonnes)	30	**16**	(14)
	73	**67**	(6)
Average prices			
Specialty grades (C $ per tonne)	1,536	**1,535**	(1)
Viscose and other grades (C $ per tonne)	1,170	**1,328**	158

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $28 million on sales of $120 million. This compares to adjusted EBITDA of $17 million on sales of $120 million in the year ago quarter. The $1 million decrease in pulp sales was due to lower shipments of viscose and other grades, largely offset by higher shipments of specialty grades.

US dollar and euro prices for specialty grade pulp increased by approximately 6% from the year ago quarter. However, a stronger Canadian dollar, which averaged 3.9% higher versus the US dollar and 7.6% higher versus the euro, offset much of the benefit and reported Canadian dollar selling prices were relatively unchanged from the year ago quarter. The $158 per tonne increase in the selling price of viscose and other grades was due to higher US dollar selling prices. Overall, the higher viscose prices increased adjusted EBITDA by $2 million. Shipments were equal to 86% of capacity as compared to 94% in the prior year quarter. There were no major maintenance outages at either pulp mill in the March 2017 and March 2016 quarters. Consequently, productivity was similar in both quarters. Mill manufacturing costs declined by $4 million, including a favourable amount of $3 million related to the currency impact of converting the Tartas mill’s costs to Canadian dollars. The higher proportion of specialty grades generated a favourable $3 million mix variance. Chemical business adjusted EBITDA was similar in both periods.

The Specialty Cellulose Pulp segment generated operating earnings of $21 million as compared to operating earnings of $10 million in the prior year quarter. The previously noted increase in adjusted EBITDA led to the higher operating results.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

SEGMENT RESULTS – PAPER PULP

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales (1)	77	**85**	8
Freight and other deductions	16	**16**	-
Cost of sales	58	**58**	-
SG&A	1	**2**	(1)
Adjusted EBITDA	2	**9**	7
Depreciation and amortization	3	**3**	-
Operating earnings (loss)	(1)	**6**	7
Shipments			
High-yield pulp (000's tonnes)	115	**121**	6
Internal (000's tonnes)	16	**15**	(1)
Total	131	**136**	5
Benchmark Prices			
BEK - delivered China (US $ per tonne)	533	**590**	57

(1) Includes intersegment sales eliminated on consolidation

The Paper Pulp segment generated adjusted EBITDA of $9 million on sales of $85 million. This compares to adjusted EBITDA of $2 million on sales of $77 million in the year ago quarter. The $8 million increase in sales was caused by higher prices and shipments.

The benchmark price for BEK increased by US $57 per tonne. The high-yield pulp market followed a similar trend and the US dollar selling prices increased by US $51 per tonne. Currency partially mitigated the impact of this increase as the Canadian dollar averaged US $0.755, a 3.9% increase versus US $0.727 in the year ago quarter. As a result, Canadian dollar prices for external high-yield pulp sales increased by $46 per tonne, increasing adjusted EBITDA by $6 million. Pulp shipments were equal to 95% of capacity as compared to 92% in the year ago quarter. The two pulp mills produced 3,600 more tonnes than in the comparable quarter a year ago and manufacturing costs were relatively unchanged.

The Paper Pulp segment generated operating earnings of $6 million compared to an operating loss of $1 million in the comparable quarter of the prior year. The previously noted increase in adjusted EBITDA led to the improvement in operating results.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

SEGMENT RESULTS – PAPER

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales	102	**96**	(6)
Freight and other deductions	12	**10**	2
Cost of sales	66	**68**	(2)
SG&A	3	**2**	1
Adjusted EBITDA	21	**16**	(5)
Depreciation and amortization	1	**1**	-
Operating earnings	20	**15**	(5)
Shipments			
Coated bleached board (000's tonnes)	45	**48**	3
Newsprint (000's tonnes)	50	**43**	(7)
Total	95	**91**	(4)
Benchmark Prices			
16 pt. Coated bleached board (US $ per short ton)	1,030	**1,010**	(20)
Newsprint - 48.8 gram East Coast (US $ per tonne)	538	**575**	37

The Paper segment generated adjusted EBITDA of $16 million on sales of $96 million. This compares to adjusted EBITDA of $21 million on sales of $102 million in the same quarter a year ago. The $6 million decrease in sales was due primarily to lower coated bleached board prices. Higher coated bleached board shipments offset lower newsprint shipments.

The US dollar benchmark price for coated bleached board decreased by US $20 per short ton. Currency was also a negative factor as the Canadian dollar averaged US $0.755, a 3.9% increase versus US $0.727 in the year ago quarter. Overall, average selling prices for coated bleached board declined by $116 per tonne, decreasing adjusted EBITDA by $5 million. The coated bleached board shipment to capacity ratio was 106% compared to 99% in the prior year quarter. Mill costs declined by $1 million. The higher sales volume added a further $1 million to adjusted EBITDA.

The US dollar benchmark price for newsprint increased by US $37 per tonne. The higher US dollar prices were more than offset by the stronger Canadian dollar and a weaker sales mix and Canadian dollar prices decreased by $13 per tonne, reducing adjusted EBITDA by $1 million. The newsprint shipment to capacity ratio was 79%, compared to 91% in the year ago quarter. Mill costs increased by $3 million, primarily for purchased electrical energy.

The Paper segment generated operating earnings of $15 million, as compared to operating earnings of $20 million in the prior year quarter. The decrease in adjusted EBITDA led to the decline in operating results.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

SEGMENT RESULTS – CORPORATE

	March 2016	**March 2017**
Financial ($ millions)		
General and administrative expenses	5	**5**
Share-based compensation	-	**4**
Operating loss	5	**9**

The Company recorded a $4 million expense for share-based compensation in the March 2017 quarter, as compared to a negligible charge in the prior year quarter. Senior executives currently participate in a long-term incentive plan which entitles participants to potentially receive units that are equal in value to one common share. The units have a defined vesting period and certain units are subject to specific conditions that ultimately determine the number of units that vest and are earned by plan participants. Non-executive members of the board of directors receive a portion of their fees in the form of “Deferred Share Units” (DSU). The DSUs vest at specified dates. The fair value of the obligation related to DSUs is estimated at each balance sheet date and a corporate expense or credit is recorded.

INTEREST, FOREIGN EXCHANGE AND OTHER

The following table summarizes interest, foreign exchange and other expenses by component:

	$ millions	
	March 2016	**March 2017**
Interest on debt	16	**15**
Amortization of financing costs	2	**1**
Foreign exchange items	2	**2**
Employee future benefits	1	**1**
Bank charges and other	1	**1**
	22	**20**

The interest expense relates primarily to interest on the US $375 million – 9% senior secured notes maturing in December 2019. Financing costs are amortized over the remaining term of each respective credit facility. Foreign exchange items are primarily caused by gains or losses on the translation of US dollar net monetary assets. The charge for employee future benefits relates to interest accretion on net unfunded obligations.

TRANSLATION OF FOREIGN DEBT

During the March 2017 quarter, the Company recorded a gain of $7 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar increased from US $0.739 to US $0.748.

During the March 2016 quarter, the Company recorded a gain of $27 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar increased from US $0.722 to US $0.755.

INCOME TAXES

The following table reconciles the anticipated income tax expense based on the statutory rate to the actual income tax expense:

	$ millions	
	March 2016	**March 2017**
Earnings before income taxes	28	**28**
Anticipated income tax expense	7	**7**
Recognition of previously unrecognized tax asset	(3)	**(4)**
Non-taxable portion of foreign exchange gain on long-term debt	(3)	**(1)**
Permanent differences and other tax adjustments	-	**2**
Income tax expense	1	**4**

During the March 2017 quarter, the Company recorded an income tax expense of $4 million on earnings before income taxes of $28 million. The income tax expense reflected a $3 million favourable variance versus an anticipated income tax expense of $7 million based on the Company's effective tax rate of 26.1%. The income tax expense decreased by $4 million as a result of the recognition of previously unrecognized tax assets. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. The non-taxable portion of the foreign exchange gain on translation of debt decreased the income tax expense by $1 million. Permanent differences and other tax adjustments increased the income tax expense by $2 million.

During the March 2016 quarter, the Company recorded an income tax expense of $1 million on earnings before income taxes of $28 million. The income tax expense reflected a $6 million favourable variance versus an anticipated income tax expense of $7 million based on the Company's effective tax rate of 26.2%. The income tax expense was decreased by $3 million as the result of the recognition of previously unrecognized tax assets. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. The non-taxable portion of the foreign exchange gain on translation of debt decreased the income tax expense by $3 million.

NET EARNINGS

The Company generated net earnings of $24 million or $0.24 per share for the quarter ended March 25, 2017, compared to net earnings of $27 million or $0.27 per share for the quarter ended March 26, 2016.

MARCH 2017 QUARTER VS MARCH 2016 QUARTER

COMPREHENSIVE EARNINGS (LOSS)

The following table summarizes the impact of items affecting the reported total comprehensive earnings (loss) during the March 2017 quarter and the comparable quarter a year ago:

	$ millions	
	March 2016	**March 2017**
Net earnings	27	**24**
Employee future benefit gain (loss)	(33)	**4**
Foreign currency translation gain (loss) on foreign operations	(4)	**5**
Total comprehensive earnings (loss)	(10)	**33**

During the March 2017 quarter, the Company recognized a gain of $4 million relating to the decrease of the estimated net obligation for employee future benefits. The return on plan assets was more than the expected return, decreasing the net obligation by $23 million. The average discount rate applied to estimate the present value of future obligations decreased from 3.84% to 3.67%, thereby increasing the net obligation by $19 million.

During the March 2016 quarter, the Company recognized a loss of $33 million relating to the increase of the estimated net obligation for employee future benefits. The return on plan assets was less than the expected return, increasing the net obligation by $2 million. The average discount rate applied to estimate the present value of future obligations decreased from 4.01% to 3.73%, thereby increasing the net obligation by $32 million. Due to the absence of current service costs in certain legacy pension plans, the Company is limited in its ability to recognize all plan assets held in trust. The recognition of previously unrecognized assets reduced the net obligation by $1 million.

Comprehensive items include gains or losses related to the currency translation of the assets and liabilities of the Company's French and U.S. operations. The gains or losses are generated by changes in the end of period exchange rates. During the March 2017 quarter, the currency translation of the French operations generated a gain of $5 million. The currency translation of the U.S. operations did not generate a gain or a loss. During the March 2016 quarter, the currency translation of the French operations generated a loss of $5 million. The currency translation of the U.S. operations generated a gain of $1 million.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

CONSOLIDATED SUMMARY

SALES

$ millions	March 2016	**March 2017**	Total Variance	Price Variance	Volume & Mix Variance
Forest Products	218	**223**	5	21	(16)
Specialty Cellulose Pulp	229	**223**	(6)	1	(7)
Paper Pulp	145	**168**	23	11	12
Paper	196	**192**	(4)	(6)	2
Corporate	2	**2**	-	-	-
	790	**808**	18	27	(9)
Less: Intersegment Sales	(56)	**(51)**	5		
Sales	734	**757**	23		

Sales increased by $23 million from the same period a year ago. Currency had a negative impact as the Canadian dollar averaged US $0.753, a 2% increase versus US $0.738 in the comparable six-month period of the prior year. Forest Products segment sales increased by $5 million as a result of higher lumber prices, partially offset by lower lumber shipments. Specialty Cellulose Pulp segment sales decreased by $6 million due primarily to lower shipments. Paper Pulp segment sales increased by $23 million due to higher shipments and prices. Paper segment sales decreased by $4 million due to lower prices, partially offset by higher shipments.

ADJUSTED EBITDA

$ millions	March 2016	**March 2017**	Total Variance	Price Variance	Cost & Volume Variance
Forest Products	-	**19**	19	21	(2)
Specialty Cellulose Pulp	36	**38**	2	1	1
Paper Pulp	-	**16**	16	11	5
Paper	37	**33**	(4)	(6)	2
Corporate	(8)	**(18)**	(10)	-	(10)
	65	**88**	23	27	(4)

Adjusted EBITDA increased by $23 million from the prior year period. Forest Products segment adjusted EBITDA increased by $19 million due to higher prices. Specialty Cellulose Pulp segment adjusted EBITDA increased by $2 million due to lower costs and higher prices. Paper Pulp segment adjusted EBITDA increased by $16 million due to higher prices and lower costs. Paper segment adjusted EBITDA decreased by $4 million due to lower prices. Corporate costs increased by $10 million primarily due to higher share-based compensation expense.

OPERATING EARNINGS (LOSS)

$ millions	March 2016	**March 2017**	Total Variance	Adjusted EBITDA Variance	Depreciation Variance	Other Items Variance
Forest Products	(3)	**16**	19	19	-	-
Specialty Cellulose Pulp	22	**24**	2	2	-	-
Paper Pulp	(6)	**10**	16	16	-	-
Paper	35	**31**	(4)	(4)	-	-
Corporate	(9)	**(19)**	(10)	(10)	-	-
	39	**62**	23	23	-	-

The Company generated operating earnings of $62 million compared to operating earnings of $39 million in the same period a year ago. The previously noted improvement in adjusted EBITDA led to the improvement in operating results. A more detailed explanation of segment variances is included in the analysis that follows.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

SEGMENT RESULTS – FOREST PRODUCTS

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales - SPF Lumber	154	**163**	9
Sales - Chips, logs and other[1]	64	**60**	(4)
	218	**223**	5
Freight and other deductions	22	**22**	-
Cost of sales	190	**176**	14
SG&A	6	**6**	-
Adjusted EBITDA	-	**19**	19
Depreciation and amortization	3	**3**	-
Operating earnings (loss)	(3)	**16**	19
Shipments			
SPF lumber (mmbf)	370	**342**	(28)
Benchmark Prices			
KD #2 & better delivered G.L. (US $ per mbf)	364	**415**	51
KD stud delivered G.L. (US $ per mbf)	297	**377**	80

(1) Includes intersegment sales eliminated on consolidation

The Forest Products segment generated adjusted EBITDA of $19 million on sales of $223 million. This compares to negligible adjusted EBITDA on sales of $218 million in the comparable period of the prior year. The $9 million increase in SPF lumber sales was due to higher lumber prices, partially offset by lower shipments.

The US dollar benchmark price for random lumber increased by US $51 per mbf while the benchmark price for stud lumber was up US $80 per mbf. Currency partially mitigated the impact of these higher prices as the Canadian dollar averaged US $0.753, a 2% increase versus US $0.738 in the comparative six-month period of the prior year. Overall, Canadian dollar selling prices increased by $61 per mbf, increasing adjusted EBITDA by $21 million. Lumber shipments were equal to 91% of capacity, compared to 87% in the year ago period. The March 2016 period capacity included the Senneterre sawmill. The current period does not include the capacity of the Senneterre sawmill. The Senneterre sawmill had generated negative adjusted EBITDA of $3 million in the prior year period. The cash cost of SPF lumber increased by $4 million.

The Forest Products segment generated operating earnings of $16 million, as compared to an operating loss of $3 million in the prior year period. The previously noted increase in adjusted EBITDA led to the improvement in operating results.

On October 31, 2016, the Company completed the sale of the Senneterre, Quebec, sawmill and related forestry assets for $8 million. This included certain working capital items totalling approximately $5 million. The assets were sold at their carrying values.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

SEGMENT RESULTS – SPECIALTY CELLULOSE PULP

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales - Pulp	188	**183**	(5)
Sales - Chemicals	41	**40**	(1)
	229	**223**	(6)
Freight and other deductions	21	**19**	2
Cost of sales	163	**158**	5
SG&A	9	**8**	1
Adjusted EBITDA	36	**38**	2
Depreciation and amortization	14	**14**	-
Operating earnings	22	**24**	2
Pulp shipments			
Specialty grades (000's tonnes)	84	**97**	13
Viscose and other grades (000's tonnes)	50	**26**	(24)
	134	**123**	(11)
Average prices			
Specialty grades (C $ per tonne)	1,555	**1,531**	(24)
Viscose and other grades (C $ per tonne)	1,148	**1,311**	163

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $38 million on sales of $223 million. This compares to adjusted EBITDA of $36 million on sales of $229 million in the comparable period a year ago. The $5 million decrease in pulp sales was due to lower shipments of viscose and other grades, partially offset by higher shipments of specialty grades.

US dollar and euro prices for specialty grade pulp increased by approximately 2% from the year ago period. However, a stronger Canadian dollar, which averaged 2% higher versus the US dollar and 4% higher versus the euro more than offset the benefit and reported Canadian dollar selling prices of specialty pulp declined by $24 per tonne. The $163 per tonne increase in the selling price of viscose and other grades was due to significantly higher US dollar selling prices. Overall, the higher viscose prices more than offset the lower specialty prices and the impact on adjusted EBITDA was an increase of $1 million. Shipments were equal to 80% of capacity as compared to 87% in the prior year period. During the six-month period ended March 2017, the Tartas specialty cellulose pulp mill was idled for 11 days due to its major maintenance outage. These occur at 18-month intervals. Tartas had no major maintenance downtime in the prior year period. As a result, the mill produced 7,400 fewer tonnes in the current six-month period. Manufacturing costs increased by $8 million, including $5 million for maintenance material and $3 million of unabsorbed fixed costs associated with the aforementioned productivity decrease. This was partially offset by a favourable variance of $3 million related to the currency impact of converting the mill's cost to Canadian dollars. The higher proportion of specialty grades generated a favourable $5 million mix variance. Chemical business adjusted EBITDA declined by $2 million due to lower selling prices.

The Specialty Cellulose Pulp segment generated operating earnings of $24 million as compared to operating earnings of $22 million in the prior year period. The previously noted increase in adjusted EBITDA led to the higher operating results.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

SEGMENT RESULTS – PAPER PULP

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales [(1)]	145	**168**	23
Freight and other deductions	30	**32**	(2)
Cost of sales	113	**117**	(4)
SG&A	2	**3**	(1)
Adjusted EBITDA	-	**16**	16
Depreciation and amortization	6	**6**	-
Operating earnings (loss)	(6)	**10**	16
Shipments			
High-yield pulp (000's tonnes)	215	**240**	25
Internal (000's tonnes)	34	**31**	(3)
Total	249	**271**	22
Benchmark Prices			
BEK - delivered China (US $ per tonne)	580	**552**	(28)

(1) Includes intersegment sales eliminated on consolidation

The Paper Pulp segment generated adjusted EBITDA of $16 million on sales of $168 million. This compares to negligible adjusted EBITDA on sales of $145 million in the year ago period. The $23 million increase in sales was due to higher shipments and prices.

The benchmark price for BEK decreased by US $28 per tonne. The high-yield pulp market did not follow this trend and the US dollar selling prices increased by US $38 per tonne. Currency partially mitigated the impact of the higher prices as the Canadian dollar averaged US $0.753, a 2% increase versus US $0.738 in the comparable six-month period of the prior year. As a result, Canadian dollar prices for external high-yield pulp sales increased by $39 per tonne, increasing adjusted EBITDA by $11 million. Pulp shipments were equal to 95% of capacity as compared to 87% in the year ago period. The March 2016 six-month period included 41 days of market downtime at the Temiscaming pulp mill due to weak market conditions. There was no market downtime in the most recent six-month period and the mill produced 28,000 more tonnes. Manufacturing costs declined by $4 million, primarily as a result of higher fixed cost absorption related to the aforementioned productivity increase. Costs at the Matane pulp mill were similar in both periods.

The Paper Pulp segment generated operating earnings of $10 million compared to an operating loss of $6 million in the comparable period of the prior year. The previously noted increase in adjusted EBITDA led to the improvement in operating results.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

SEGMENT RESULTS – PAPER

	March 2016	**March 2017**	Variance
Financial ($ millions)			
Sales	196	**192**	(4)
Freight and other deductions	23	**20**	3
Cost of sales	131	**134**	(3)
SG&A	5	**5**	-
Adjusted EBITDA	37	**33**	(4)
Depreciation and amortization	2	**2**	-
Operating earnings	35	**31**	(4)
Shipments			
Coated bleached board (000's tonnes)	85	**93**	8
Newsprint (000's tonnes)	104	**89**	(15)
Total	189	**182**	(7)
Benchmark Prices			
16 pt. Coated bleached board (US $ per short ton)	1,030	**1,010**	(20)
Newsprint - 48.8 gram East Coast (US $ per tonne)	522	**575**	53

The Paper segment generated adjusted EBITDA of $33 million on sales of $192 million. This compares to adjusted EBITDA of $37 million on sales of $196 million in the same period a year ago. The $4 million decrease in sales was due to lower newsprint shipments and lower prices for coated bleached board, partially offset by higher shipments of coated bleached board.

The US dollar benchmark price for coated bleached board decreased by US $20 per short ton. Currency was also a negative factor as the Canadian dollar averaged US $0.753, a 2% increase versus US $0.738 in the year ago period. Overall, average selling prices for coated bleached board rolls declined by $83 per tonne, decreasing adjusted EBITDA by $6 million. The coated bleached board shipment to capacity ratio was 104% compared to 95% in the prior year period. Mill costs declined by $2 million. The higher sales volume added a further $2 million to adjusted EBITDA.

The US dollar benchmark price for newsprint increased by US $53 per tonne. The higher US dollar prices were partially offset by a weaker sales mix and the previously noted stronger Canadian dollar. Selling prices increased by $15 per tonne, increasing adjusted EBITDA by $1 million. The newsprint shipment to capacity ratio was 81%, compared to 94% in the year ago period. Mill costs increased by $3 million.

The Paper segment generated operating earnings of $31 million, as compared to operating earnings of $35 million in the prior year period. The decrease in adjusted EBITDA led to the decline in operating results.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

SEGMENT RESULTS – CORPORATE

	March 2016	**March 2017**
Financial ($ millions)		
General and administrative expenses	9	**10**
Share-based compensation	(1)	**8**
Other items:		
Custodial - idled facilities	1	**1**
Operating loss	9	**19**

The Company recorded an $8 million expense for share-based compensation in the March 2017 six-month period, as compared to a $1 million credit in the prior year period. Senior executives currently participate in a long-term incentive plan which entitles participants to potentially receive units that are equal in value to one common share. The units have a defined vesting period and certain units are subject to specific conditions that ultimately determine the number of units that vest and are earned by plan participants. Non-executive members of the board of directors receive a portion of their fees in the form of "Deferred Share Units" (DSU). The DSUs vest at specified dates. The fair value of the obligation related to DSUs is estimated at each balance sheet date and a corporate expense or credit is recorded.

The Corporate segment's "other items" include expenses relating to several permanently idled facilities. The costs relate to custodial, site security, legal, pension plan administration and remediation activities. These "legacy" items totalled $1 million in both periods.

INTEREST, FOREIGN EXCHANGE AND OTHER

The following table summarizes interest, foreign exchange and other expenses by component:

	$ millions	
	March 2016	**March 2017**
Interest on debt	31	**30**
Amortization of financing costs	3	**3**
Foreign exchange items	1	**(1)**
Employee future benefits	2	**2**
Bank charges and other	2	**2**
	39	**36**

The interest expense relates primarily to interest on the US $375 million – 9% senior secured notes maturing in December 2019. Financing costs are amortized over the remaining term of each respective credit facility. Foreign exchange items are primarily caused by gains or losses on the translation of US dollar net monetary assets. The charge for employee future benefits relates to interest accretion on net unfunded obligations.

TRANSLATION OF FOREIGN DEBT

During the six-month period ended March 2017, the Company recorded a loss of $9 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.759 to US $0.748.

During the six-month period ended March 2016, the Company recorded a gain of $3 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar increased from US $0.751 to US $0.755.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

INCOME TAXES

The following table reconciles the anticipated income tax expense based on the statutory rate to the actual income tax expense:

	$ millions	
	March 2016	**March 2017**
Earnings before income taxes	3	**17**
Anticipated income tax expense	1	**4**
Recognition of previously unrecognized tax asset	-	**(9)**
Decrease in income tax rates	-	**5**
Unrecognized tax asset	1	**-**
Non-deductible portion of foreign exchange loss on long-term debt	-	**1**
Permanent differences and other tax adjustments	2	**1**
Income tax expense	4	**2**

During the six-month period ended March 2017, the Company recorded an income tax expense of $2 million on earnings before income taxes of $17 million. The income tax expense reflected a $2 million favourable variance versus an anticipated income tax expense of $4 million based on the Company's effective tax rate of 26.1%. The income tax expense decreased by $9 million as a result of the recognition of previously unrecognized tax assets. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. Lower income tax rates increased the income tax expense by $5 million. The non-deductible portion of the foreign exchange loss on translation of debt increased the income tax expense by $1 million. Permanent differences and other tax adjustments increased the income tax expense by $1 million.

During the six-month period ended March 2016, the Company recorded an income tax expense of $4 million on earnings before income taxes of $3 million. The income tax expense reflected a $3 million unfavourable variance versus an anticipated income tax expense of $1 million based on the Company's effective tax rate of 26.2%. The income tax expense was increased by $1 million as the result of losses for which no deferred tax asset was recognized. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. Permanent differences and other tax adjustments increased the income tax expense by $2 million.

NET EARNINGS (LOSS)

The Company generated net earnings of $15 million or $0.15 per share for the six-month period ended March 25, 2017, compared to a net loss of $1 million or $0.01 per share for the six-month period ended March 26, 2016.

SIX MONTHS ENDED MARCH 2017 VS SIX MONTHS ENDED MARCH 2016

COMPREHENSIVE EARNINGS (LOSS)

The following table summarizes the impact of items affecting the reported total comprehensive earnings (loss) during the March 2017 six-month period and the comparable period a year ago:

	$ millions	
	March 2016	**March 2017**
Net earnings (loss)	(1)	**15**
Employee future benefit gain (loss)	(24)	**54**
Income tax expense	-	**(2)**
Foreign currency translation loss on foreign operations	(1)	**(5)**
Total comprehensive earnings (loss)	(26)	**62**

During the six-month period ended March 2017, the Company recognized a gain of $54 million relating to the decrease of the estimated net obligation for employee future benefits. The return on plan assets was more than the expected return, decreasing the net obligation by $3 million. The average discount rate applied to estimate the present value of future obligations increased from 3.24% to 3.67%, thereby decreasing the net obligation by $48 million. Due to the absence of current service costs in certain legacy pension plans, the Company is limited in its ability to recognize all plan assets held in trust. The recognition of previously unrecognized assets reduced the net obligation by $1 million. Changes to demographic assumptions reduced the net obligation by $2 million. The Company recorded an income tax expense of $2 million related to the aforementioned gain of $54 million.

During the six-month period ended March 2016, the Company recognized a loss of $24 million relating to the increase of the estimated net obligation for employee future benefits. The return on plan assets was more than the expected return, reducing the net obligation by $12 million. The average discount rate applied to estimate the present value of future obligations decreased from 4.04% to 3.73%, thereby increasing the net obligation by $37 million. Due to the absence of current service costs in certain legacy pension plans, the Company is limited in its ability to recognize all plan assets held in trust. The recognition of previously unrecognized assets reduced the net obligation by $1 million.

Comprehensive items include gains or losses related to the currency translation of the assets and liabilities of the Company's French and U.S. operations. The gains or losses are generated by changes in the end of period exchange rates. During the six-month period ended March 2017, the currency translation of the French operations generated a loss of $5 million. The currency translation of the U.S. operations did not generate a gain or a loss. During the six-month period ended March 2016, the currency translation of the French operations generated a loss of $1 million. The currency translation of the U.S. operations did not generate a gain or a loss.

SELECTED QUARTERLY INFORMATION

Selected quarterly information for the eight most recently completed fiscal quarters is disclosed below.

	$ millions (except as otherwise noted)							
	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**
Sales	365	373	354	380	376	389	370	**387**
Adjusted EBITDA	2	36	29	36	26	57	34	**54**
Depreciation and amortization	12	12	12	13	13	15	12	**13**
Other items expense (credit)	1	-	1	-	(5)	-	1	**-**
Operating earnings (loss)	(11)	24	16	23	18	42	21	**41**
Net earnings (loss)	(16)	(32)	(28)	27	9	12	(9)	**24**
Basic and fully diluted net earnings (loss) per share ($)	(0.16)	(0.32)	(0.28)	0.27	0.09	0.12	(0.09)	**0.24**
Comprehensive earnings (loss)	5	(29)	(16)	(10)	(8)	22	29	**33**

FINANCIAL POSITION

CASH FLOW – OPERATIONS

	($ millions)							
	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Cash flow from operations before working capital changes	22	35	21	48	34	**53**	-	-
Less:								
Additions to property, plant and equipment	10	7	10	17	10	**6**	-	-
Interest on debt	15	16	15	15	15	**15**	-	-
Free cash flow (negative)	(3)	12	(4)	16	9	**32**	-	-

Cash flow from operations before working capital changes for the first six months of fiscal 2017 was $87 million, compared to $57 million in the prior year period. The $23 million increase in adjusted EBITDA, which included a $9 million increase in non-cash share-based compensation expense led to the higher cash flow from operations before working capital changes. After allowing for capital expenditures of $16 million and interest on debt of $30 million, free cash flow for the first six months of fiscal 2017 was $41 million compared to $9 million in the prior year period.

FINANCIAL POSITION

CAPITAL EXPENDITURES

The following table summarizes capital expenditures by segment:

$ millions	Quarters ended March 2016	**March 2017**	Six months ended March 2016	**March 2017**
Forest Products	1	**1**	3	**4**
Specialty Cellulose Pulp	4	**2**	9	**5**
Paper Pulp	1	**-**	3	**2**
Paper	1	**2**	2	**4**
Corporate	-	**1**	-	**1**
	7	**6**	17	**16**

During the first six months of fiscal 2017, capital expenditures totalled $16 million, compared to $17 million in the prior year period. There were no significant large projects under construction in either period.

During the month of March 2017, the Company became eligible for the "Tarif L" program in the Province of Quebec. The program allows large industrial electricity consumption sites, such as Temiscaming and Matane, to benefit from electricity rebates conditional on proceeding with expenditures related to qualified capital projects. The program covers capital expenditures from April 2016 to December 2020. The payment of the electricity rebates will only commence once the Company's cumulative expenditures have reached a specified threshold. Based on current forecast spending, the Company estimates that the rebates would commence in the spring of 2018. During the March 2017 quarter, the Company recorded a receivable of $3 million related to the Tarif L program and reported capital expenditures were reduced by this amount.

LIQUIDITY

The Company has set an objective of maintaining a minimum liquidity of $135 million to $150 million. As at March 25, 2017, the Company had total cash, including restricted cash, of $57 million plus unused operating lines of $126 million, for total liquidity of $183 million. At September 24, 2016, the date of the last audited consolidated financial statements, the Company had total cash, including restricted cash, of $46 million and unused operating lines of $102 million, for total liquidity of $148 million.

The following table summarizes operating bank loan availability and utilization:

Operating Bank Loans $ millions	September 2016	December 2016	**March 2017**
Borrowing base	190	186	**187**
Less: fixed availability reserves	(31)	(15)	**(15)**
Less: variable availability reserves	-	-	**-**
Net availability	159	171	**172**
Outstanding letters of credit	(45)	(45)	**(42)**
Amount drawn	(12)	(20)	**(4)**
Unused amount	102	106	**126**

The Company's current ABL consists of a $150 million revolving credit facility (revolving loan) and a US $50 million "first in, last out" term loan (FILO). The FILO tranche is classified as long-term debt and bears interest at a rate of LIBOR + 7.25% subject to a 1% LIBOR floor. The revolving loan will expire on November 18, 2020, provided several conditions are met, including repayment of the FILO loan on or prior to its maturity date of September 30, 2018. Failure to repay the FILO loan by its maturity date would accelerate the maturity date of the revolving loan to September 30, 2018. The ABL has a first priority charge over the receivables and inventories of the Company's Canadian and U.S. operations. It is also secured by a first priority charge on the fixed assets of one of the Company's U.S. subsidiaries.

FINANCIAL POSITION

The ABL credit agreement contains an annual mandatory prepayment clause related to the FILO loan. The amount of the annual mandatory prepayment is based on the Company's profitability in the prior fiscal year. The prepayment can only be made if ABL revolver availability is at or above $100 million after the prepayment is made. Based on the Company's fiscal 2016 results, the amount of the prepayment was calculated to be $16 million. There is no prepayment premium or penalty applicable to the mandatory prepayment. In late November 2016, the FILO loan lenders waived the mandatory prepayment. In December 2016, the Company made a voluntary principal prepayment of $16 million (US $12 million) on the FILO loan. The Company also paid a 1% prepayment penalty on the US $12 million. The balance outstanding on the FILO loan at the end of the March 2017 quarter was $67 million (US $50 million). As a result of the voluntary prepayment, the fixed availability reserves on the revolver portion of the ABL declined by $16 million. As at the end of the March 2017 quarter, an amount of $135 million was available on the revolver portion of the ABL and no amount was drawn on the facility other than letter of credit utilization noted below.

The outstanding letters of credit constitute security for various operating items, principally the unfunded portion of supplementary retirement plans, future landfill closure liabilities and performance guarantees related to electricity generation agreements. The Company also has a dedicated unsecured credit facility that can only be utilized to issue letters of credit. At the end of the March 2017 quarter, there were $8 million of outstanding letters of credit issued on this facility. The remaining $34 million of letters of credit have been issued under the ABL revolver facility.

The French operations are supported by a "receivable factoring" agreement. As at the end of the March 2017 quarter, an amount of $29 million was available and an amount of $4 million was drawn on this facility.

The Company's liquidity is dependent on generating a sufficient amount of adjusted EBITDA and cash flow from operations. Based on existing liquidity and anticipated future operating cash flow, the Company believes that it will be able to adequately fund its operations and meet its future obligations as they become due. This determination could be impacted by economic, financial, competitive, legislative and regulatory factors, as well as other events, that are beyond the Company's control.

LONG-TERM DEBT

	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Net debt ($ millions)	776	758	712	682	689	**653**	-	-
Net debt / LTM (last twelve months) adjusted EBITDA (times)	9.8	7.4	5.6	4.6	4.5	**3.8**	-	-
LTM adjusted EBITDA / LTM interest on indebtedness (times)	1.4	1.8	2.1	2.4	2.5	**2.9**	-	-
Net debt / total capitalization (%)	78%	77%	76%	74%	74%	**71%**	-	-

The Company has set certain objectives relating to its level of indebtedness. The Company's long-term objectives are to reduce net debt to $500 million, maintain a net debt to LTM adjusted EBITDA of 3 or less, an interest coverage target of 3 or more and a net debt to total capitalization target of 40% or less. The detailed calculations are outlined in the Definitions – non-IFRS financial measures section of the MD&A. The Company recognizes that the significant investment in the Temiscaming cogen project led to an increase in debt levels. With no significant large capital expenditure projects in the near term, the focus will be to continue to reduce leverage.

In October 2014, the Company completed a private debt offering of US $375 million – 9% senior secured notes. The secured notes mature in December 2019. The senior secured notes have a first ranking charge on the majority of the Company's Canadian fixed assets and associated spare parts as well as a second ranking charge on the majority of the accounts receivable and inventory associated with the aforementioned fixed assets.

FINANCIAL POSITION

The Company entered into a $40 million term loan facility to assist with the financing of the specialty cellulose cogeneration project in Temiscaming, Quebec. The loan is secured by a first ranking charge on the project assets. On July 12, 2012, the Company received an advance of $20 million bearing interest at 6.35% repayable in blended monthly instalments over a period of eight years beginning in July 2014, with a "balloon" payment of $12 million to be repaid in July 2022. On October 18, 2013, the Company received an advance of $20 million bearing interest at 6.86%, repayable in blended monthly instalments over a period of eight years beginning in November 2014 with a "balloon" payment of $12 million to be repaid in October 2022. As at the end of March 2017, the Company had repaid $5 million of the principal related to the term loan and $35 million remained outstanding.

In connection with the specialty cellulose cogeneration project in Temiscaming, Quebec, the Company entered into a $75 million term loan facility, bearing interest at 5.5%. The term loan facility of $75 million will be repaid in 112 equal monthly payments beginning in January 2019. The loan is secured by a second ranking charge on the project assets. The Company entered into an additional term loan facility to borrow up to $18 million with the same lender, at an interest rate of 5.5%. The $18 million term loan facility will be repaid in 15 equal monthly payments of $520,000 beginning in December 2018 and a "balloon" payment of $10 million in March 2020. The additional loan is also secured by a second ranking charge on the project assets.

CREDIT RATINGS

During the March 2017 quarter, Moody's Investors Service (Moody's) increased the rating on the 9% senior secured notes as well as the Company's corporate credit rating from B3 to B2. They also changed their outlook from "negative" to "stable". Standard and Poor's (S&P) has assigned a B- rating to the 9% senior secured notes and the same level for the Company's corporate credit rating. S&P has a "stable" outlook with respect to its rating.

CAPITAL STOCK INFORMATION

As at May 2, 2017, issued and outstanding capital shares consisted of 100,000,000 common shares (100,000,000 as at September 24, 2016). In fiscal 2013, the Company granted a lender a five-year option to acquire 3 million common shares at a price of $7 per share. The option expires on August 30, 2017. In fiscal 2014, the Company granted the same lender a five-year option to acquire 712,000 common shares at a price of $3.783 per share. The option expires on December 11, 2018.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended March 25, 2017, the Company did not make any changes to its internal controls over financial reporting that would have materially affected, or would likely materially affect, such controls.

SUBSEQUENT EVENT

On November 25, 2016, a petition for the imposition of countervailing and antidumping duties (CVD and ADD) on softwood lumber from Canada was filed with the U.S. International Trade Commission (USITC) by the Committee Overseeing Action for Lumber International Trade Investigations or Negotiations.

The U.S. Department of Commerce (USDOC) initiated a CVD and ADD investigation. On April 24, 2017, the USDOC announced its preliminary determination on the CVD and imposed a preliminary duty rate of 19.88% for the Company. The CVD will require cash deposits on sales of softwood lumber to the U.S.

The USDOC also made a preliminary determination that critical circumstances existed, which result in CVD on sales of softwood lumber applying retroactively effective 90 days prior to publication of the preliminary determination in the Federal Register.

The ADD investigation is still underway and a preliminary determination is expected in June 2017. The USDOC also made a preliminary determination that critical circumstances existed, which will result in ADD on sales of softwood lumber applying retroactively effective 90 days prior to publication of the preliminary ADD determination in the Federal Register.

SUBSEQUENT EVENT

The Company and other Canadian forest product companies, the Federal Government and Canadian provincial governments (Canadian Interests) categorically deny the US allegations and strongly disagree with the preliminary determinations made by the USITC and USDOC. Canadian Interests continue to aggressively defend the Canadian industry in this trade dispute. Depending on the outcome of the final phase of the investigation, Canadian Interests may appeal the decision of these administrative agencies to the appropriate courts, North American Free Trade Agreement (NAFTA) panels and the World Trade Organization (WTO). Notwithstanding the preliminary rate established in the investigations, the final liability for the assessment of CVD and ADD will not be determined until the administrative review process is complete. The final amount and the effective date of CVD and ADD that may be assessed on Canadian softwood lumber exports to the U.S. cannot be determined at this time and will depend on determinations yet to be made by the USDOC and USITC and any reviewing courts, NAFTA or WTO panels to which those determinations may be appealed.

For accounting purposes, the Company has not accrued any retroactive CVD for the 90-day period prior to publication of the preliminary determination in the Federal Register which is estimated to be $9 million in total. Management believes that the critical circumstances finding by the USDOC will not be upheld by either the USDOC or the USITC in their final determinations. The Company expects that it will be required to pay these amounts in trust pending final determinations by the USDOC and USITC and will record these amounts as deposits receivable when made. Any adjustments to management's estimates will be made prospectively if assumptions or conclusions change due to new information warranting a change in the estimates.

OUTLOOK

Overall, the March 2017 quarterly results exceeded expectations as all four business segments generated operating earnings ahead of forecast. Currency was not a significant factor as the Canadian dollar averaged 0.5% higher versus the US dollar in the March 2017 quarter.

The $18 million increase in adjusted EBITDA for the Specialty Cellulose segment was largely expected. The combination of reduced maintenance, higher productivity and higher prices for certain specialty grades and viscose grades were all contributing factors that increased adjusted EBITDA margins beyond 25% for the quarter. While the Company anticipates continued strong results from this line of business, the June 2017 financial results will be impacted by the planned major maintenance outage at the Temiscaming mill in the month of May. Lumber markets continued to perform well and prices increased quarter-over-quarter. The recently announced CVD preliminary determination will impact the Company's financial results and liquidity in future periods. A preliminary determination on ADD is expected in the June quarter. The Company anticipates that a portion of the CVD and ADD will be passed on to customers in the form of higher lumber prices. The implementation of CVD and ADD deposits will likely lead to more volatility as Canadian producers adapt to the changing circumstances. The Paper Pulp segment results continue to exceed expectations. Anticipated new BEK pulp capacity has been ramping up at a slower pace than initially expected. However, this new capacity will eventually occur, putting pressure on the hardwood pulp market. The Paper segment generated adjusted EBITDA of $16 million, which represents another solid quarter for the segment and it should continue to perform well. The coated bleached board market is well balanced leading to continued pricing stability. The newsprint market continues to experience declining demand and will require further capacity reduction to maintain a balanced market.

With trailing twelve-month adjusted EBITDA of $171 million, including $8 million of share-based compensation expense, the Company continued to demonstrate the positive impact on margins of the Temiscaming cogeneration project as well as other cost reduction and productivity initiatives. The Company will continue to focus on controllable items such as cost and working capital items with a goal of further improving operating margins. While the CVD and ADD deposits will impact future cash flow, the Company's relatively high liquidity combined with anticipated improving margins have put it in a good position to continue to reduce its level of indebtedness and proceed with cost reducing capital expenditures.

OTHER DATA

		Fiscal 2016				Fiscal 2017			
		Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Shares outstanding - end of quarter (millions)		100	100	100	100	100	**100**	-	-
Book value per share ($)		0.55	0.45	0.37	0.59	0.88	**1.21**	-	-
Foreign exchange:									
1 C $ = US $	- average	0.749	0.727	0.776	0.767	0.751	**0.755**	-	-
	- period end	0.722	0.755	0.769	0.759	0.739	**0.748**	-	-
1 euro = US $	- average	1.094	1.101	1.131	1.116	1.083	**1.064**	-	-
	- period end	1.095	1.117	1.108	1.123	1.045	**1.080**	-	-
1 euro = C $	- average	1.460	1.515	1.457	1.455	1.443	**1.408**	-	-
	- period end	1.516	1.480	1.441	1.479	1.414	**1.445**	-	-

DEFINITIONS – NON-IFRS FINANCIAL MEASURES

The following summarizes non-IFRS financial measures utilized in the MD&A. As there is no generally accepted method of calculating these financial measures, they may not be comparable to similar measures reported by other companies.

Adjusted EBITDA refers to earnings before interest, income taxes, depreciation, amortization and other items. Since the Company excludes “other items” such as gains and losses on significant asset disposals, restructuring charges and custodial costs for permanently idled facilities, it differs from EBITDA. Adjusted EBITDA does not have any standardized meaning according to IFRS. The Company defines adjusted EBITDA as sales less cost of sales and selling, general and administrative expenses, meaning it represents operating earnings before depreciation, amortization and other items. The Company considers adjusted EBITDA to be a useful indicator of the financial performance of the Company, the business segments and the individual business units. The most comparable financial measure is operating earnings or loss. The following table is a reconciliation of quarterly operating earnings to the Company’s definition of adjusted EBITDA:

	$ millions							
	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Operating earnings	16	23	18	42	21	**41**	-	-
Depreciation and amortization	12	13	13	15	12	**13**	-	-
Other items expense (credit)	1	-	(5)	-	1	**-**	-	-
Adjusted EBITDA	29	36	26	57	34	**54**	-	-

Free cash flow refers to cash provided by operating activities before changes in non-cash working capital balances less interest expense and capital expenditures. Working capital changes are excluded as they are often seasonal and temporary in nature. The Company considers free cash flow to be a useful indicator of its ability to generate discretionary cash flow, thereby improving its overall liquidity position.

Net debt refers to debt less cash, cash equivalents and restricted cash.

Total capitalization refers to net debt plus deferred tax liabilities, employee future benefit liabilities, long-term provisions, other long-term liabilities, and shareholders’ equity.

Net debt to total capitalization is used by the Company to measure its financial leverage.

	$ millions							
	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Operating bank loans / Bank indebtedness	69	77	43	7	15	**4**	-	-
Long-term debt	711	685	689	679	694	**688**	-	-
Net unamortized financing costs (1)	25	23	21	20	19	**13**	-	-
Current portion of long-term debt	14	16	6	22	6	**5**	-	-
Less: cash, cash equivalents and restricted cash	(43)	(43)	(47)	(46)	(45)	**(57)**	-	-
Net debt	776	758	712	682	689	**653**	-	-
Long-term liabilities (2)	158	178	188	183	149	**149**	-	-
Shareholders' equity	55	45	37	59	88	**121**	-	-
Total capitalization	989	981	937	924	926	**923**	-	-
Net debt to total capitalization ratio	78%	77%	76%	74%	74%	**71%**	-	-

(1) Includes both current and long-term portion

(2) Not adjusted for liabilities held for sale

DEFINITIONS – NON-IFRS FINANCIAL MEASURES

Net debt to LTM (last twelve months) adjusted EBITDA is used by the Company to measure its financial leverage.

	$ millions							
	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
Net debt	776	758	712	682	689	**653**	-	-
LTM adjusted EBITDA	79	103	127	148	153	**171**	-	-
Net debt to LTM adjusted EBITDA (times)	9.8	7.4	5.6	4.6	4.5	**3.8**	-	-

LTM adjusted EBITDA to LTM interest on indebtedness is used by the Company to measure its financial leverage.

	$ millions							
	Fiscal 2016				Fiscal 2017			
	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	**Mar 17**	Jun 17	Sep 17
LTM adjusted EBITDA	79	103	127	148	153	**171**	-	-
LTM interest on indebtedness	55	58	60	61	61	**60**	-	-
LTM adjusted EBITDA / LTM interest on indebtedness (times)	1.4	1.8	2.1	2.4	2.5	**2.9**	-	-

TEMBEC INC.
CONSOLIDATED BALANCE SHEETS

(unaudited) (in millions of Canadian dollars)

	Mar. 25, 2017	Sept. 24, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 55**	$ 44
Restricted cash	**2**	2
Trade and other receivables	**147**	153
Inventories (note 3)	**305**	273
Prepaid expenses	**8**	9
Assets classified as held for sale (note 4)	**-**	10
	517	491
Property, plant and equipment (note 5)	**628**	639
Biological assets	**3**	3
Employee future benefits	**40**	23
Other assets	**7**	2
Deferred tax assets	**3**	2
	$ 1,198	$ 1,160
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Operating bank loans (note 6)	**$ 4**	$ 7
Trade, other payables and accrued charges	**215**	193
Interest payable	**13**	13
Income tax payable	**1**	-
Provisions	**2**	4
Current portion of long-term debt (note 7)	**5**	22
Liabilities classified as held for sale (note 4)	**-**	1
	240	240
Long-term debt (note 7)	**688**	679
Provisions	**12**	12
Employee future benefits	**136**	169
Other long-term liabilities	**1**	1
	1,077	1,101
Shareholders' equity:		
Share capital (note 8)	**568**	568
Accumulated other comprehensive earnings	**10**	15
Deficit	**(457)**	(524)
	121	59
	$ 1,198	$ 1,160

Subsequent event (note 15)

The accompanying notes are an integral part of these interim consolidated financial statements.

TEMBEC INC.
CONSOLIDATED STATEMENTS OF NET EARNINGS (LOSS)

Quarters and six months ended March 25, 2017 and March 26, 2016
(unaudited) (in millions of Canadian dollars, unless otherwise noted)

	Quarters				Six months			
		2017		2016		**2017**		2016
Sales	**$**	**387**	$	380	**$**	**757**	$	734
Freight and other deductions		**47**		49		**93**		96
Cost of sales (excluding depreciation and amortization)		**266**		279		**536**		543
Selling, general and administrative		**16**		16		**32**		31
Share-based compensation		**4**		-		**8**		(1)
Depreciation and amortization		**13**		13		**25**		25
Other items (note 9)		**-**		-		**1**		1
Operating earnings		**41**		23		**62**		39
Interest, foreign exchange and other		**20**		22		**36**		39
Foreign exchange loss (gain) on long-term debt		**(7)**		(27)		**9**		(3)
Net finance costs (income) (note 10)		**13**		(5)		**45**		36
Earnings before income taxes		**28**		28		**17**		3
Income tax expense (note 11)		**4**		1		**2**		4
Net earnings (loss)	**$**	**24**	$	27	**$**	**15**	$	(1)
Basic and diluted net earnings (loss) in dollars per share (note 8)	**$**	**0.24**	$	0.27	**$**	**0.15**	$	(0.01)

TEMBEC INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS (LOSS)

Quarters and six months ended March 25, 2017 and March 26, 2016
(unaudited) (in millions of Canadian dollars)

	Quarters				Six months			
		2017		2016		**2017**		2016
Net earnings (loss)	**$**	**24**	$	27	**$**	**15**	$	(1)
Other comprehensive earnings (loss), net of income taxes:								
Items that will never be reclassified to earnings (loss):								
Defined benefit pension plans and other benefit plans (note 12)		**4**		(33)		**54**		(24)
Income tax expense		**-**		-		**(2)**		-
		4		(33)		**52**		(24)
Item that may be reclassified to earnings (loss) in future periods:								
Foreign currency translation differences for foreign operations		**5**		(4)		**(5)**		(1)
Other comprehensive earnings (loss)		**9**		(37)		**47**		(25)
Total comprehensive earnings (loss)	**$**	**33**	$	(10)	**$**	**62**	$	(26)

The accompanying notes are an integral part of these interim consolidated financial statements.

TEMBEC INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Quarters and six months ended March 25, 2017 and March 26, 2016
(unaudited) (in millions of Canadian dollars)

	Quarters		Six months	
	2017	2016	**2017**	2016
Share capital	**$ 568**	$ 568	**$ 568**	$ 568
Accumulated other comprehensive earnings:				
Balance - beginning of period	**$ 5**	$ 19	**$ 15**	$ 16
Foreign currency translation differences for foreign operations	**5**	(4)	**(5)**	(1)
Balance - end of period	**$ 10**	$ 15	**$ 10**	$ 15
Deficit:				
Balance - beginning of period	**$ (485)**	$ (532)	**$ (524)**	$ (513)
Net earnings (loss) for the period	**24**	27	**15**	(1)
Other comprehensive earnings (loss):				
Defined benefit pension plans and other benefit plans (note 12)	**4**	(33)	**54**	(24)
Income tax expense	**-**	-	**(2)**	-
Balance - end of period	**$ (457)**	$ (538)	**$ (457)**	$ (538)
Shareholders' equity	**$ 121**	$ 45	**$ 121**	$ 45

The accompanying notes are an integral part of these interim consolidated financial statements.

TEMBEC INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

Quarters and six months ended March 25, 2017 and March 26, 2016
(unaudited) (in millions of Canadian dollars)

	Quarters		Six months	
	2017	2016	**2017**	2016
Cash flows from operating activities:				
Net earnings (loss)	**$ 24**	$ 27	**$ 15**	$ (1)
Adjustments for:				
Depreciation and amortization	**13**	13	**25**	25
Net finance costs (income) (note 10)	**13**	(5)	**45**	36
Foreign exchange and bank charges	**(1)**	(3)	**(1)**	(3)
Income tax expense (note 11)	**4**	1	**2**	4
Income tax refund (paid)	**(2)**	2	**(4)**	-
Difference between cash contributions and employee future benefits expense	**-**	(1)	**1**	(2)
Share-based compensation	**4**	-	**8**	(1)
Other	**(2)**	1	**(4)**	(1)
	53	35	**87**	57
Changes in non-cash working capital:				
Trade and other receivables	**(6)**	4	**7**	16
Inventories	**(37)**	(43)	**(31)**	(47)
Prepaid expenses	**-**	(1)	**-**	(1)
Trade, other payables and accrued charges	**31**	8	**21**	3
	(12)	(32)	**(3)**	(29)
	41	3	**84**	28
Cash flows used in investing activities:				
Disbursements for property, plant and equipment	**(9)**	(7)	**(23)**	(18)
Proceeds from sale of Senneterre sawmill (note 4)	**-**	-	**8**	-
Change in restricted cash	**-**	4	**-**	(4)
	(9)	(3)	**(15)**	(22)
Cash flows from (used in) financing activities:				
Repayment of asset-based loan	**-**	-	**-**	(105)
Proceeds from new asset-based loan	**-**	-	**-**	61
Change in operating bank loans	**(16)**	8	**(9)**	6
Increase in long-term debt (note 7)	**-**	2	**-**	80
Repayments of long-term debt (note 7)	**(1)**	(2)	**(18)**	(3)
Interest paid	**(4)**	(5)	**(30)**	(30)
	(21)	3	**(57)**	9
	11	3	**12**	15
Foreign exchange gain (loss) on cash and cash equivalents held in foreign currencies	**1**	-	**(1)**	-
Net increase in cash and cash equivalents	**12**	3	**11**	15
Cash and cash equivalents, beginning of period	**43**	33	**44**	21
Cash and cash equivalents, end of period	**$ 55**	$ 36	**$ 55**	$ 36

The accompanying notes are an integral part of these interim consolidated financial statements.

TEMBEC INC.
CONSOLIDATED BUSINESS SEGMENT INFORMATION

Quarters ended March 25, 2017 and March 26, 2016
(unaudited) (in millions of Canadian dollars)

							Quarter ended March 25, 2017
	Forest Products	**Specialty Cellulose**	**Paper Pulp**	**Paper**	**Corporate**	**Consolidation adjustments**	**Consolidated**
Sales:							
External	**$ 94**	**$ 120**	**$ 77**	**$ 96**	**$ -**	**$ -**	**$ 387**
Internal	**16**	**-**	**8**	**-**	**1**	**(25)**	**-**
	110	**120**	**85**	**96**	**1**	**(25)**	**387**
Freight and other deductions	**11**	**10**	**16**	**10**	**-**	**-**	**47**
Cost of sales	**86**	**78**	**58**	**68**	**1**	**(25)**	**266**
Selling, general and administrative	**3**	**4**	**2**	**2**	**5**	**-**	**16**
Share-based compensation	**-**	**-**	**-**	**-**	**4**	**-**	**4**
Earnings (loss) before the following (adjusted EBITDA):	**10**	**28**	**9**	**16**	**(9)**	**-**	**54**
Depreciation and amortization	**2**	**7**	**3**	**1**	**-**	**-**	**13**
Other items (note 9)	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Operating earnings (loss)	**$ 8**	**$ 21**	**$ 6**	**$ 15**	**$ (9)**	**$ -**	**$ 41**
Additions to property, plant and equipment	**$ 1**	**$ 2**	**$ -**	**$ 2**	**$ 1**	**$ -**	**$ 6**
Total assets	**$ 189**	**$ 674**	**$ 128**	**$ 153**	**$ 54**	**$ -**	**$ 1,198**
Total liabilities	**$ 58**	**$ 268**	**$ 45**	**$ 72**	**$ 634**	**$ -**	**$ 1,077**

							Quarter ended March 26, 2016
	Forest Products	Specialty Cellulose	Paper Pulp	Paper	Corporate	Consolidation adjustments	Consolidated
Sales:							
External	$ 90	$ 119	$ 69	$ 102	$ -	$ -	$ 380
Internal	18	1	8	-	1	(28)	-
	108	120	77	102	1	(28)	380
Freight and other deductions	10	11	16	12	-	-	49
Cost of sales	94	88	58	66	1	(28)	279
Selling, general and administrative	3	4	1	3	5	-	16
Share-based compensation	-	-	-	-	-	-	-
Earnings (loss) before the following (adjusted EBITDA):	1	17	2	21	(5)	-	36
Depreciation and amortization	2	7	3	1	-	-	13
Other items (note 9)	-	-	-	-	-	-	-
Operating earnings (loss)	$ (1)	$ 10	$ (1)	$ 20	$ (5)	$ -	$ 23
Additions to property, plant and equipment	$ 1	$ 4	$ 1	$ 1	$ -	$ -	$ 7
Total assets	$ 196	$ 688	$ 140	$ 172	$ 12	$ -	$ 1,208
Total liabilities	$ 56	$ 255	$ 30	$ 81	$ 741	$ -	$ 1,163

TEMBEC INC.
CONSOLIDATED BUSINESS SEGMENT INFORMATION

Six months ended March 25, 2017 and March 26, 2016
(unaudited) (in millions of Canadian dollars)

							Six months ended March 25, 2017
	Forest Products	Specialty Cellulose	Paper Pulp	Paper	Corporate	Consolidation adjustments	Consolidated
Sales:							
External	**$ 190**	**$ 223**	**$ 152**	**$ 192**	**$ -**	**$ -**	**$ 757**
Internal	**33**	**-**	**16**	**-**	**2**	**(51)**	**-**
	223	**223**	**168**	**192**	**2**	**(51)**	**757**
Freight and other deductions	**22**	**19**	**32**	**20**	**-**	**-**	**93**
Cost of sales	**176**	**158**	**117**	**134**	**2**	**(51)**	**536**
Selling, general and administrative	**6**	**8**	**3**	**5**	**10**	**-**	**32**
Share-based compensation	**-**	**-**	**-**	**-**	**8**	**-**	**8**
Earnings (loss) before the following (adjusted EBITDA):	**19**	**38**	**16**	**33**	**(18)**	**-**	**88**
Depreciation and amortization	**3**	**14**	**6**	**2**	**-**	**-**	**25**
Other items (note 9)	**-**	**-**	**-**	**-**	**1**	**-**	**1**
Operating earnings (loss)	**$ 16**	**$ 24**	**$ 10**	**$ 31**	**$ (19)**	**$ -**	**$ 62**
Additions to property, plant and equipment	**$ 4**	**$ 5**	**$ 2**	**$ 4**	**$ 1**	**$ -**	**$ 16**
Total assets	**$ 189**	**$ 674**	**$ 128**	**$ 153**	**$ 54**	**$ -**	**$ 1,198**
Total liabilities	**$ 58**	**$ 268**	**$ 45**	**$ 72**	**$ 634**	**$ -**	**$ 1,077**

							Six months ended March 26, 2016
	Forest Products	Specialty Cellulose	Paper Pulp	Paper	Corporate	Consolidation adjustments	Consolidated
Sales:							
External	$ 183	$ 227	$ 128	$ 196	$ -	$ -	$ 734
Internal	35	2	17	-	2	(56)	-
	218	229	145	196	2	(56)	734
Freight and other deductions	22	21	30	23	-	-	96
Cost of sales	190	163	113	131	2	(56)	543
Selling, general and administrative	6	9	2	5	9	-	31
Share-based compensation	-	-	-	-	(1)	-	(1)
Earnings (loss) before the following (adjusted EBITDA):	-	36	-	37	(8)	-	65
Depreciation and amortization	3	14	6	2	-	-	25
Other items (note 9)	-	-	-	-	1	-	1
Operating earnings (loss)	$ (3)	$ 22	$ (6)	$ 35	$ (9)	$ -	$ 39
Additions to property, plant and equipment	$ 3	$ 9	$ 3	$ 2	$ -	$ -	$ 17
Total assets	$ 196	$ 688	$ 140	$ 172	$ 12	$ -	$ 1,208
Total liabilities	$ 56	$ 255	$ 30	$ 81	$ 741	$ -	$ 1,163

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

1. Reporting entity and nature of operations

Tembec Inc. is incorporated and domiciled in Canada and listed on the Toronto Stock Exchange under the symbol TMB. The address of the registered office is 4 Place Ville-Marie, Suite 100, Montreal, Quebec, Canada, H3B 2E7.

Tembec Inc. (the "Corporation") and its subsidiaries (collectively "Tembec" or the "Company") operate an integrated forest products business.

2. Basis of presentation and new standards

Statement of compliance

These unaudited interim consolidated financial statements and the notes thereto have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) applicable to the preparation of interim financial statements, including International Accounting Standard (IAS) 34 – *Interim Financial Reporting*.

The accounting policies and the basis of presentation applied in these unaudited interim consolidated financial statements are consistent with those applied and disclosed in the Company's audited consolidated financial statements for the year ended September 24, 2016. Income taxes in the interim periods are accrued using the tax rate that would be applicable to expected total annual profit or loss. The Company's interim results are not necessarily indicative of its results for a full year.

These unaudited interim consolidated financial statements do not include all of the information and disclosures required in the annual financial statements and, accordingly, should be read in conjunction with the Company's audited consolidated financial statements for the year ended September 24, 2016.

These unaudited interim consolidated financial statements were authorized for issue by the Board of Directors on May 2, 2017.

Accounting estimates and judgments

The preparation of unaudited interim consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expense. Actual results may differ from those estimates.

In preparing these unaudited interim consolidated financial statements, the significant judgments made by management in applying the Company's significant accounting policies and key sources of information were the same as those applied to the audited consolidated financial statements for the year ended September 24, 2016.

3. Inventories

	Mar. 25, 2017	Sept. 24, 2016
Finished goods	**$ 125**	$ 123
Logs and wood chips	**102**	72
Supplies and spare parts	**78**	78
	$ 305	$ 273
Inventories carried at net realizable value	**$ 4**	$ 24

Inventories at March 25, 2017, were written down by $1 million (September 24, 2016 - $1 million) to reflect net realizable value being lower than cost. The write-down and reversal, if any, are included in cost of sales.

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

4. Assets and liabilities classified as held for sale

On October 31, 2016, the Company completed the sale of its softwood lumber (SPF) sawmill located in Senneterre, Quebec, including certain working capital items and the related forestry operations.

Total net proceeds received upon completion of the sale were $8 million including post-closing working capital adjustments. As the net assets were sold at their carrying values, the sale did not give rise to a gain or loss on disposition.

As at September 24, 2016, these assets and liabilities were classified as held for sale.

5. Property, plant and equipment

	Net book value	
	Mar. 25, 2017	Sept. 24, 2016
Land	**$ 3**	$ 3
Buildings	**87**	89
Production equipment:		
Pulp and paper	**484**	493
Sawmill	**21**	20
Forest access roads	**12**	11
Assets under construction	**21**	23
	$ 628	$ 639

For the six-month period ended March 25, 2017, the Company had additions to property, plant and equipment of $16 million.

During the March 2017 quarter, the Company became eligible for the "Tarif L" program, which allows large industrial electricity consumption sites to benefit from electricity rebates conditional on proceeding with expenditures related to qualified capital projects. The Company recognizes the electricity rebates as a reduction of the cost of the asset to which they relate at the time the eligible capital expenditures are incurred.

6. Operating bank loans

	Mar. 25, 2017	Sept. 24, 2016
Operating bank loans - Canadian operations	**$ -**	$ 10
Operating bank loans - French operations	**4**	2
	4	12
Less unamortized financing costs	**-**	5
	$ 4	$ 7

As at March 25, 2017, the Canadian operations were supported by a $150 million asset-based revolving credit facility (ABL). The amount available, based on eligible receivables and inventories, was $135 million of which $34 million was reserved for letters of credit. Interest is calculated based on the Canadian base rate plus an applicable margin of 1.5% at the end of the March 2017 quarter.

The French operations are supported by "receivable factoring" agreements. As such, the borrowing base fluctuates periodically, depending on shipments and cash receipts. As at March 25, 2017, the amount available was $29 million, of which $4 million was drawn.

As at March 25, 2017, the unamortized financing costs of $4 million are included in other assets as no amount is borrowed under the ABL.

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

7. Long-term debt

	Maturity	Mar. 25, 2017	Sept. 24, 2016
Tembec Industries Inc. - US $375 million - 9% senior secured notes	12/2019	**$ 502**	$ 494
Tembec Industries Inc. - US $50 million (September 2016 - US $62 million) - LIBOR + 7.25% FILO term loan	09/2018	**67**	82
Tembec Energy LP - 5.5% term loan secured by a second ranking charge	04/2028	**75**	75
Tembec Energy LP - 5.5% term loan secured by a second ranking charge	03/2020	**18**	18
Tembec Energy LP - 6.86% term loan secured by a first ranking charge	10/2022	**18**	18
Tembec Energy LP - 6.35% term loan secured by a first ranking charge	07/2022	**17**	18
Tembec Tartas SAS	Various	**9**	10
Other	Various	**-**	1
		706	716
Less current portion		**5**	22
Less unamortized financing costs		**13**	15
		$ 688	$ 679

On October 18, 2016, the Company entered into an agreement to extend the maturity date of the FILO term loan from March 2018 to September 2018.

On December 22, 2016, the Company prepaid an amount of $16 million (US $12 million) on the FILO term loan.

The Company's credit agreements contain terms and conditions that could in certain circumstances restrict the ability of the Company to incur or guarantee additional indebtedness, to encumber or dispose of its assets or make certain payments or distributions.

8. Share capital

Issued and fully paid

	Mar. 25, 2017	Sept. 24, 2016
100,000,000 common shares	**$ 564**	$ 564
3,712,000 warrants	**4**	4
	$ 568	$ 568

Net earnings (loss) per share

The following table provides the reconciliation between basic and diluted net earnings (loss) per share:

	Quarters		Six months	
	2017	2016	**2017**	2016
Net earnings (loss)	**$ 24**	$ 27	**$ 15**	$ (1)
Weighted average number of common shares outstanding	**100,000,000**	100,000,000	**100,000,000**	100,000,000
Dilutive effect of employee share options and warrants	**-**	-	**-**	-
Weighted average number of diluted common shares outstanding	**100,000,000**	100,000,000	**100,000,000**	100,000,000
Basic and diluted net earnings (loss) in dollars per share	**$ 0.24**	$ 0.27	**$ 0.15**	$ (0.01)

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

8. Share capital (continued)

Share-based compensation

During the December 2016 quarter, 957,746 Deferred Share Units (DSUs) were granted to senior executives under the Performance-Conditioned Share Unit (PCSU) plan and 491,839 DSUs were forfeited as performance conditions attached to it were not achieved. As at March 25, 2017, 3,173,852 DSUs are outstanding having a carrying value of $3 million recorded in trade, other payables and accrued charges.

During the December 2016 quarter, 1,306,032 DSUs were granted to non-executive members of the Board under the Directors' Share Award Plan. During the March 2017 quarter, 66,102 DSUs were granted. These DSUs vest in three equal amounts at the date of the next three Annual General Shareholders' meetings beginning on January 26, 2017. As at March 25, 2017, 3,106,860 DSUs are outstanding having a carrying value of $7 million recorded in trade, other payables and accrued charges.

9. Other items

The following table provides a summary of the other items by business segment of the Company:

	Quarters		Six months	
	2017	2016	**2017**	2016
Corporate:				
Costs for permanently idled facilities	**$ -**	$ -	**$ 1**	$ 1

During the March 2017 quarter, the Company recorded a negligible amount (March 2016 – negligible amount) relating to several permanently idled facilities. These costs relate to custodial, site security, legal, pension plans administration and remediation activities. For the six-month period ended March 25, 2017, these charges amounted to $1 million (March 2016 - $1 million).

10. Net finance costs (income)

	Quarters		Six months	
	2017	2016	**2017**	2016
Interest on long-term debt	**$ 15**	$ 15	**$ 30**	$ 29
Interest on short-term debt	**-**	1	**-**	2
Amortization of financing costs using the effective interest method	**1**	2	**3**	3
Bank charges and other financing expenses	**1**	1	**2**	2
Net foreign exchange loss (gain), excluding exchange on long-term debt	**2**	2	**(1)**	1
Foreign exchange loss (gain) on long-term debt	**(7)**	(27)	**9**	(3)
Net interest cost on defined benefit plans	**1**	1	**2**	2
	$ 13	$ (5)	**$ 45**	$ 36
Finance costs	**$ 20**	$ 22	**$ 46**	$ 39
Finance income	**(7)**	(27)	**(1)**	(3)
Net finance costs (income)	**$ 13**	$ (5)	**$ 45**	$ 36

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

11. Income taxes

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

	Quarters		Six months	
	2017	2016	**2017**	2016
Earnings before income taxes	**$ 28**	$ 28	**$ 17**	$ 3
Income tax expense based on combined federal and provincial income tax rates of 26.1% (Fiscal 2016 - 26.2%)	**$ 7**	$ 7	**$ 4**	$ 1
Increase (decrease) resulting from:				
Difference in statutory income tax rates	**2**	-	**2**	1
Unrecognized tax assets	**-**	-	**-**	1
Recognition of previously unrecognized tax assets	**(4)**	(3)	**(9)**	-
Deferred income tax adjustment due to rate enactment	**-**	-	**5**	-
Non-deductible (non-taxable) portion of foreign exchange loss (gain) on long-term debt	**(1)**	(3)	**1**	-
Permanent differences and other tax adjustments	**-**	-	**(1)**	1
	(3)	(6)	**(2)**	3
Income tax expense	**$ 4**	$ 1	**$ 2**	$ 4
Income taxes:				
Current	**$ 3**	$ 1	**$ 4**	$ 3
Deferred	**1**	-	**(2)**	1
Income tax expense	**$ 4**	$ 1	**$ 2**	$ 4

12. Employee future benefits

The Company measures its defined benefit obligations and the fair value of plan assets at year-end. At the end of each interim reporting period, the Company estimates changes in its accrued benefit liabilities based upon variations in discount rates and rates of return on plan assets, as well as any significant changes to the plans.

The following table presents the Company's employee future benefit costs included in the consolidated statements of net earnings (loss):

	Quarters		Six months	
	2017	2016	**2017**	2016
Defined benefit pension plans	**$ 2**	$ 3	**$ 5**	$ 5
Defined contribution and other retirement plans	**1**	1	**3**	3
Other benefit plans	**1**	-	**1**	-
Current service cost	**$ 4**	$ 4	**$ 9**	$ 8
Administrative expenses	**$ 1**	$ 1	**$ 1**	$ 1
Net interest cost	**$ 1**	$ 1	**$ 2**	$ 2

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

12. Employee future benefits (continued)

The actuarial gains (losses) on employee future benefits included in other comprehensive earnings (loss) are as follows:

	Quarters		Six months	
	2017	2016	**2017**	2016
Actuarial gain (loss) - variation in discount rate	**$ (19)**	$ (32)	**$ 48**	$ (37)
Return on plan assets - excluding interest income	**23**	(2)	**3**	12
Actuarial gain - demographic assumptions	**-**	-	**2**	-
Effect of limit on recognition of assets / minimum funding requirement	**-**	1	**1**	1
	$ 4	$ (33)	**$ 54**	$ (24)

The actuarial gain (loss) on variation in discount rate recognized in the statement of comprehensive earnings (loss) for the period ended March 25, 2017, was based on a variation of the discount rate for pension plans from 3.24% used at September 24, 2016, to 3.84% used at December 24, 2016 and 3.67% at March 25, 2017. The actual rate of return for the six-month period was approximately 1.8% (annualized 3.6%), which is 0.2% higher than the amount recorded in interest income of 1.6% (annualized 3.2%).

13. Financial instruments

Fair value

The carrying value and the fair value of the long-term debt are as follows:

	Mar. 25, 2017	Sept. 24, 2016
Long-term debt:		
Carrying value	**$ 693**	$ 701
Fair value	**$ 721**	$ 594

Financial risk management

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 is as follows:

	Mar. 25, 2017	Sept. 24, 2016
Loans and receivables, other than cash, cash equivalents and restricted cash	**$ 148**	$ 154
Cash, cash equivalents and restricted cash	**$ 57**	$ 46

Exposure to liquidity risk

The Company has an objective of maintaining liquidity equal to 12 months of maintenance capital expenditures, interest and principal repayments, seasonal working capital requirements and general corporate purposes, which would amount to approximately $135 million to $150 million of liquidity.

(unaudited) (in millions of Canadian dollars, unless otherwise noted)

13. Financial instruments (continued)

Repayment of amounts due within one year is funded by normal collection of current trade accounts receivable. Liquidity in the form of cash, cash equivalents, restricted cash and unused revolving credit facilities is also maintained to assist in the solvency and financial flexibility of the Company. Liquidity as at March 25, 2017, totalled $183 million (September 24, 2016 – $148 million).

The following are the contractual maturities of financial liabilities, including interest payments:

						March 25, 2017
	Carrying amount	Contractual cash flows	Year 1	Years 2-3	Years 4-5	After 5 years
Secured loans	$ 684	$ 867	$ 63	$ 680	$ 41	$ 83
Unsecured loans	9	9	3	4	2	-
Operating bank loans	4	4	4	-	-	-
Trade and others	229	230	229	1	-	-
	$ 926	$ 1,110	$ 299	$ 685	$ 43	$ 83

14. Capital management

The Company has set the following objectives relating to its level of indebtedness: net debt to last twelve months (LTM) adjusted EBITDA, LTM adjusted EBITDA to LTM interest on indebtedness and net debt to total capitalization.

The following table presents the debt ratios versus the objectives:

	Objective	**Mar. 25, 2017**	Sept. 24, 2016
Net debt / LTM adjusted EBITDA (times)	3 or less	**3.8**	4.6
LTM adjusted EBITDA / LTM interest on indebtedness (times)	3 or more	**2.9**	2.4
Net debt / total capitalization (%)	40% or less	**71%**	74%

The Company anticipates that the ratios will continue to improve as the Temiscaming cogeneration generates incremental adjusted EBITDA.

There were no changes in the Company’s approach to capital management during the period.

15. Subsequent event

On November 25, 2016, a petition for the imposition of countervailing and antidumping duties (CVD and ADD) on softwood lumber from Canada was filed with the U.S. International Trade Commission (USITC) by the Committee Overseeing Action for Lumber International Trade Investigations or Negotiations.

The U.S. Department of Commerce (USDOC) initiated a CVD and ADD investigation. On April 24, 2017, the USDOC announced its preliminary determination on the CVD and imposed a preliminary duty rate of 19.88% for the Company. The CVD will require cash deposits on sales of softwood lumber to the U.S.

The USDOC also made a preliminary determination that critical circumstances existed, which result in CVD on sales of softwood lumber applying retroactively effective 90 days prior to publication of the preliminary determination in the Federal Register.

The ADD investigation is still underway and a preliminary determination is expected in June 2017. The USDOC also made a preliminary determination that critical circumstances existed, which will result in ADD on sales of softwood lumber applying retroactively effective 90 days prior to publication of the preliminary ADD determination in the Federal Register.

15. Subsequent event (continued)

The Company and other Canadian forest product companies, the Federal Government and Canadian provincial governments (Canadian Interests) categorically deny the US allegations and strongly disagree with the preliminary determinations made by the USITC and USDOC. Canadian Interests continue to aggressively defend the Canadian industry in this trade dispute. Depending on the outcome of the final phase of the investigation, Canadian Interests may appeal the decision of these administrative agencies to the appropriate courts, North American Free Trade Agreement (NAFTA) panels and the World Trade Organization (WTO). Notwithstanding the preliminary rate established in the investigations, the final liability for the assessment of CVD and ADD will not be determined until the administrative review process is complete. The final amount and the effective date of CVD and ADD that may be assessed on Canadian softwood lumber exports to the U.S. cannot be determined at this time and will depend on determinations yet to be made by the USDOC and USITC and any reviewing courts, NAFTA or WTO panels to which those determinations may be appealed.

For accounting purposes, the Company has not accrued any retroactive CVD for the 90-day period prior to publication of the preliminary determination in the Federal Register which is estimated to be $9 million in total. Management believes that the critical circumstances finding by the USDOC will not be upheld by either the USDOC or the USITC in their final determinations. The Company expects that it will be required to pay these amounts in trust pending final determinations by the USDOC and USITC and will record these amounts as deposits receivable when made. Any adjustments to management’s estimates will be made prospectively if assumptions or conclusions change due to new information warranting a change in the estimates.