PRESS RELEASE

TEMBEC REPORTS FINANCIAL RESULTS FOR ITS FIRST FISCAL QUARTER ENDED DECEMBER 24, 2016

Montreal, Quebec, January 26, 2017: Consolidated sales for the three-month period ended December 24, 2016, were $370 million, as compared to $354 million in the same quarter a year ago. The Company generated a net loss of $9 million or $0.09 per share in the December 2016 quarter compared to a net loss of $28 million or $0.28 per share in the December 2015 quarter. The December 2016 quarter included a non-cash loss of $16 million related to the translation of US dollar denominated debt. Operating earnings before depreciation, amortization and other items (adjusted EBITDA) was $34 million for the three-month period ended December 24, 2016, as compared to adjusted EBITDA of $29 million a year ago and adjusted EBITDA of $57 million in the prior quarter.

Business Segment Results

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $10 million on sales of $103 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $23 million on sales of $122 million in the September 2016 quarter. The pulp sales decrease of $18 million was due to lower shipments, partially offset by higher selling prices. Canadian dollar selling prices for specialty grades improved by $11 per tonne. The increase was currency and mix driven as US dollar and euro prices for specialty pulp were relatively unchanged quarter-over-quarter. The higher effective Canadian dollar prices increased adjusted EBITDA by $1 million. The $154 per tonne increase in the selling price of viscose and other grades was due to higher US dollar selling prices and a weaker Canadian dollar, which declined by 2.1% versus the prior quarter. The higher viscose grade prices increased adjusted EBITDA by $1 million. Shipments were equal to 73% of capacity, compared to 94% in the September 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 had been no maintenance outages at either facility in the September 2016 quarter. As a result, the pulp mills produced 13,900 fewer tonnes in the December 2016 quarter. Manufacturing costs increased by $12 million quarter-over-quarter, including $4 million for maintenance material and $6 million of unabsorbed fixed costs associated with the aforementioned productivity decrease. The lower pulp shipments generated an unfavourable $2 million variance. Chemical business adjusted EBITDA declined by $2 million as the fall and winter months are seasonally slower for the lignosulfonate business.

The Forest Products segment generated adjusted EBITDA of $9 million on sales of $113 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $12 million on sales of $113 million in the prior quarter. SPF lumber sales increased by $2 million due to higher prices and shipments. Sales of logs decreased by $2 million due to the seasonal decrease in activity in the fall and winter months. During the December 2016 quarter, the random length lumber reference price decreased by US $21 per mbf while the reference price for stud lumber decreased by US $7 per mbf. Currency was a positive factor as the Canadian dollar averaged US $0.751, a 2.1% decrease from US $0.767 in the prior quarter. The net effect was that Canadian dollar selling prices increased by $6 per mbf, increasing adjusted EBITDA by $1 million. Lumber shipments were equal to 95% of capacity, as compared to 82% in the prior quarter. The September 2016 quarter capacity included the Senneterre sawmill. The current quarter does not include the capacity of the Senneterre sawmill as it was sold. The cash cost of SPF lumber increased by $4 million, primarily for purchased fibre. The fall and winter months are normally higher cost operating periods.

The Paper Pulp segment generated adjusted EBITDA of $7 million on sales of $83 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $8 million on sales of $83 million in the September 2016 quarter. Sales were unchanged as higher prices offset lower shipments. The benchmark price (delivered China) for bleached eucalyptus kraft (BEK) increased by US $18 per tonne. US dollar prices for high-yield pulp followed a similar trend, increasing by US $9 per tonne quarter-over-quarter. Currency was a favourable factor as the Canadian dollar weakened versus the US dollar. Overall, average selling prices for external sales in Canadian dollars increased by $24 per tonne, increasing adjusted EBITDA by $3 million. Pulp shipments were equal to 95% of capacity as compared to 98% in the prior quarter. Mill level costs increased by $3 million as the two pulp mills produced 9,800 fewer tonnes.

The Paper segment generated adjusted EBITDA of $17 million on sales of $96 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $19 million on sales of $97 million in the September 2016 quarter. The $1 million decrease in sales was due to lower coated bleached board shipments, partially offset by higher coated bleached board prices and higher newsprint shipments. The US dollar reference price for coated bleached board was unchanged quarter-over-quarter. Currency was a positive factor as the Canadian dollar was weaker. Overall, average selling prices for coated bleached board were up $22 per tonne increasing adjusted EBITDA by $1 million. The coated bleached board shipment to capacity ratio was 101% compared to 107% in the prior quarter. Manufacturing costs increased by $2 million. The US dollar benchmark price for newsprint was unchanged quarter-over-quarter. The previously noted decline in the relative value of the Canadian dollar favourably impacted price realizations, but this was partially offset by a less favourable sales mix. Overall, average selling prices for newsprint increased by $2 per tonne and did not impact adjusted EBITDA. The newsprint shipment to capacity ratio was 82% compared to 78% in the prior quarter. Costs were similar to the prior quarter.

Outlook

Overall, the December 2016 quarterly results were as anticipated. The $13 million adjusted EBITDA decrease in the Specialty Cellulose segment was expected due to significant planned major maintenance. The 11-day maintenance outage at the Tartas specialty pulp mill cost more than originally forecast due to additional repairs on the biomass boiler. Higher viscose prices combined with a weaker Canadian dollar had a positive impact on Canadian dollar selling prices. A significant rebound in profitability in the March 2017 quarter is expected. Non-acetate specialty grade prices will increase by 5% to 7% and there will be no planned major maintenance in the quarter at either of the two specialty pulp mills. Lumber markets continued to show "late season" strength and prices were relatively robust during what is normally a slow period. Lumber market fundamentals should continue to gradually improve over time. The Paper Pulp segment results were better than anticipated. The market reacted positively to the news that a large BEK expansion project would be ramping up at a slower rate than initially expected. However, this new capacity will eventually occur, putting pressure on the hardwood pulp market. The Paper segment adjusted EBITDA of $17 million represented another solid quarter for this segment and it should continue to perform well. With trailing twelve-month adjusted EBITDA having reached $153 million, the Company has been able to demonstrate the positive impact on margins generated by the Temiscaming Cogen project as well as other cost reduction initiatives. The Company will continue to focus on cost and working capital reductions with a goal of further improving operating results and reducing the Company's overall level of indebtedness.

Tembec is a manufacturer of forest products – lumber, pulp, paper and specialty cellulose – and a global leader in sustainable forest management practices. Principal operations are in Canada and France. With annual sales of approximately $1.5 billion, Tembec has approximately 3,000 employees and is listed on the TSX (TMB). The full quarterly report, including the interim Management Discussion and Analysis, the interim financial statements and the accompanying notes for the quarter ended December 24, 2016, can be obtained on Tembec's website at www.tembec.com or on SEDAR at www.sedar.com.

The Company`s financial results have 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 and certain other financial measures utilized in the press release 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 interim Management Discussion and Analysis (MD&A).

This press release 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.

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Management's Discussion and Analysis
for the quarter ended December 24, 2016

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 first fiscal quarter ended December 24, 2016. The MD&A should be read in conjunction with the unaudited interim consolidated financial statements for the period ended December 24, 2016, 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 January 26, 2017, the date of filing in conjunction with the Company's press release announcing its results for the first 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**	-	-	-
Freight and other deductions	47	49	49	48	**46**	-	-	-
Cost of sales	264	279	284	270	**270**	-	-	-
SG&A	15	16	16	15	**16**	-	-	-
Share-based compensation	(1)	-	1	(1)	**4**	-	-	-
Adjusted EBITDA	29	36	26	57	**34**	-	-	-
Depreciation and amortization	12	13	13	15	**12**	-	-	-
Other items	1	-	(5)	-	**1**	-	-	-
Operating earnings	16	23	18	42	**21**	-	-	-
Interest, foreign exchange and other	17	22	18	18	**16**	-	-	-
Foreign exchange loss (gain) on long-term debt	24	(27)	(11)	8	**16**	-	-	-
Earnings (loss) before income taxes	(25)	28	11	16	**(11)**	-	-	-
Income tax expense (recovery)	3	1	2	4	**(2)**	-	-	-
Net earnings (loss)	(28)	27	9	12	**(9)**	-	-	-

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

CONSOLIDATED SUMMARY

SALES

$ millions	September 2016	**December 2016**	Total Variance	Price Variance	Volume & Mix Variance
Forest Products	113	**113**	-	1	(1)
Specialty Cellulose Pulp	122	**103**	(19)	2	(21)
Paper Pulp	83	**83**	-	3	(3)
Paper	97	**96**	(1)	1	(2)
Corporate	1	**1**	-	-	-
	416	**396**	(20)	7	(27)
Less: Intersegment Sales	(27)	**(26)**	1		
Sales	389	**370**	(19)		

Sales decreased by $19 million as compared to the prior quarter. Currency had a positive effect on pricing as the Canadian dollar averaged US $0.751, a decrease of 2.1% from US $0.767 in the prior quarter. Forest Products segment sales were unchanged, with higher lumber prices offset by lower volumes of log sales. Specialty Cellulose Pulp segment sales decreased by $19 million due primarily to lower shipments. Paper Pulp segment sales were unchanged with higher prices offset by lower shipments. Paper segment sales decreased by $1 million due to lower shipments of coated bleached board, partially offset by higher prices.

ADJUSTED EBITDA

$ millions	September 2016	**December 2016**	Total Variance	Price Variance	Cost & Volume Variance
Forest Products	12	**9**	(3)	1	(4)
Specialty Cellulose Pulp	23	**10**	(13)	2	(15)
Paper Pulp	8	**7**	(1)	3	(4)
Paper	19	**17**	(2)	1	(3)
Corporate	(5)	**(9)**	(4)	-	(4)
	57	**34**	(23)	7	(30)

Adjusted EBITDA decreased by $23 million as compared to the prior quarter. The Forest Products segment adjusted EBITDA decreased by $3 million as a result of higher costs. Specialty Cellulose Pulp segment adjusted EBITDA decreased by $13 million due to higher costs and lower volumes. Paper Pulp segment adjusted EBITDA was down $1 million due to higher costs, partially offset by higher selling prices. Paper segment adjusted EBITDA decreased by $2 million due to higher costs. Corporate costs increased by $4 million due to share-based compensation expense.

OPERATING EARNINGS (LOSS)

$ millions	September 2016	**December 2016**	Total Variance	Adjusted EBITDA Variance	Depreciation Variance	Other Items Variance
Forest Products	10	**8**	(2)	(3)	1	-
Specialty Cellulose Pulp	16	**3**	(13)	(13)	-	-
Paper Pulp	5	**4**	(1)	(1)	-	-
Paper	17	**16**	(1)	(2)	1	-
Corporate	(6)	**(10)**	(4)	(4)	1	(1)
	42	**21**	(21)	(23)	3	(1)

The Company generated operating earnings of $21 million compared to operating earnings of $42 million in the prior quarter. The previously noted decrease in adjusted EBITDA led to the decline in operating results. A $3 million decrease in depreciation expense provided a partial offset. A more detailed explanation of segment variances is included in the analysis that follows.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

SEGMENT RESULTS – FOREST PRODUCTS

	September 2016	**December 2016**	Variance
Financial ($ millions)			
Sales - SPF Lumber	81	**83**	2
Sales - Chips, logs and other(1)	32	**30**	(2)
	113	**113**	-
Freight and other deductions	10	**11**	(1)
Cost of sales	88	**90**	(2)
SG&A	3	**3**	-
Adjusted EBITDA	12	**9**	(3)
Depreciation and amortization	2	**1**	1
Operating earnings	10	**8**	(2)
Shipments			
SPF (spruce/pine/fir) lumber (mmbf)	176	**179**	3
Benchmark Prices			
KD #2 & better delivered G.L. (US $ per mbf)	424	**403**	(21)
KD stud delivered G.L. (US $ per mbf)	367	**360**	(7)

(1) Includes intersegment sales eliminated on consolidation

The Forest Products segment generated adjusted EBITDA of $9 million on sales of $113 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $12 million on sales of $113 million in the prior quarter. SPF lumber sales increased by $2 million due to higher prices and shipments. Sales of logs decreased by $2 million due to the seasonal decrease in activity in the fall and winter months.

During the December 2016 quarter, the random length lumber reference price decreased by US $21 per mbf while the reference price for stud lumber decreased by US $7 per mbf. Currency was a positive factor as the Canadian dollar averaged US $0.751, a 2.1% decrease from US $0.767 in the prior quarter. The net effect was that Canadian dollar selling prices increased by $6 per mbf, increasing adjusted EBITDA by $1 million. Lumber shipments were equal to 95% of capacity, as compared to 82% in the prior quarter. The September 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 $4 million, primarily for purchased fibre. The fall and winter months are normally higher cost operating periods.

The Forest Products segment generated operating earnings of $8 million, compared to operating earnings of $10 million in the September 2016 quarter. The decrease in adjusted EBITDA led to the decline 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.

On November 25, 2016, the U.S. Lumber Coalition filed a petition with the U.S. Department of Commerce (DOC) and the U.S. International Trade Commission to impose duties on imports of Canadian softwood lumber to the U.S. On December 15, 2016, the U.S. DOC agreed to conduct Countervailing Duty (CVD) and Anti-Dumping Duty (AD) investigations of Canadian softwood lumber exports to the U.S. The preliminary CVD determination is expected to occur in February 2017, while the preliminary AD determination is expected in early May 2017.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

SEGMENT RESULTS – SPECIALTY CELLULOSE PULP

	September 2016	**December 2016**	Variance
Financial ($ millions)			
Sales - Pulp	102	**84**	(18)
Sales - Chemicals	20	**19**	(1)
	122	**103**	(19)
Freight and other deductions	12	**9**	3
Cost of sales	84	**80**	4
SG&A	3	**4**	(1)
Adjusted EBITDA	23	**10**	(13)
Depreciation and amortization	7	**7**	-
Operating earnings	16	**3**	(13)
Pulp shipments			
Specialty grades (000's tonnes)	52	**46**	(6)
Viscose and other grades (000's tonnes)	20	**10**	(10)
	72	**56**	(16)
Average prices			
Specialty grades (C $ per tonne)	1,517	**1,528**	11
Viscose and other grades (C $ per tonne)	1,131	**1,285**	154

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $10 million on sales of $103 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $23 million on sales of $122 million in the September 2016 quarter. The pulp sales decrease of $18 million was due to lower shipments, partially offset by higher selling prices.

Canadian dollar selling prices for specialty grades improved by $11 per tonne. The increase was currency and mix driven as US dollar and euro prices for specialty pulp were relatively unchanged quarter-over-quarter. The higher effective Canadian dollar prices increased adjusted EBITDA by $1 million. The $154 per tonne increase in the selling price of viscose and other grades was due to higher US dollar selling prices and a weaker Canadian dollar, which declined by 2.1% versus the prior quarter. The higher viscose grade prices increased adjusted EBITDA by $1 million. Shipments were equal to 73% of capacity, compared to 94% in the September 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 had been no maintenance outages at either facility in the September 2016 quarter. As a result, the pulp mills produced 13,900 fewer tonnes in the December 2016 quarter. Manufacturing costs increased by $12 million quarter-over-quarter, including $4 million for maintenance material and $6 million of unabsorbed fixed costs associated with the aforementioned productivity decrease. The lower pulp shipments generated an unfavourable $2 million variance. Chemical business adjusted EBITDA declined by $2 million as the fall and winter months are seasonally slower for the lignosulfonate business. Finished goods inventories of specialty cellulose pulp were at approximately 30 days of supply at the end of December 2016, compared to 32 days at the end of the prior quarter.

The Specialty Cellulose Pulp segment generated operating earnings of $3 million, compared to operating earnings of $16 million in the September 2016 quarter. The previously noted decrease in adjusted EBITDA led to the decline in operating results.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

SEGMENT RESULTS – PAPER PULP

	September 2016	**December 2016**	Variance
Financial ($ millions)			
Sales [(1)]	83	**83**	-
Freight and other deductions	16	**16**	-
Cost of sales	58	**59**	(1)
SG&A	1	**1**	-
Adjusted EBITDA	8	**7**	(1)
Depreciation and amortization	3	**3**	-
Operating earnings	5	**4**	(1)
Shipments			
High-yield pulp (000's tonnes)	123	**120**	(3)
Internal (000's tonnes)	16	**15**	(1)
Total	139	**135**	(4)
Benchmark Prices			
BEK - delivered China (US $ per tonne)	495	**513**	18

(1) Includes intersegment sales eliminated on consolidation

The Paper Pulp segment generated adjusted EBITDA of $7 million on sales of $83 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $8 million on sales of $83 million in the September 2016 quarter. Sales were unchanged as higher prices offset lower shipments.

The benchmark price (delivered China) for bleached eucalyptus kraft (BEK) increased by US $18 per tonne. US dollar prices for high-yield pulp followed a similar trend, increasing by US $9 per tonne quarter-over-quarter. Currency was a favourable factor as the Canadian dollar averaged US $0.751, a 2.1% decrease from US $0.767 in the prior quarter. Overall, average selling prices for external sales in Canadian dollars increased by $24 per tonne, increasing adjusted EBITDA by $3 million. Pulp shipments were equal to 95% of capacity as compared to 98% in the prior quarter. Mill level costs increased by $3 million as the two pulp mills produced 9,800 fewer tonnes. Paper pulp inventories were at 22 days of supply at the end of December 2016, as compared to 25 days at the end of September 2016.

The Paper Pulp segment generated operating earnings of $4 million in the December 2016 quarter, compared to operating earnings of $5 million in the prior quarter. The decrease in adjusted EBITDA led to the decline in operating results.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

SEGMENT RESULTS – PAPER

	September 2016	**December 2016**	Variance
Financial ($ millions)			
Sales	97	**96**	(1)
Freight and other deductions	10	**10**	-
Cost of sales	66	**66**	-
SG&A	2	**3**	(1)
Adjusted EBITDA	19	**17**	(2)
Depreciation and amortization	2	**1**	1
Operating earnings	17	**16**	(1)
Shipments			
Coated bleached board (000's tonnes)	48	**46**	(2)
Newsprint (000's tonnes)	43	**45**	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 $17 million on sales of $96 million for the quarter ended December 24, 2016, compared to adjusted EBITDA of $19 million on sales of $97 million in the September 2016 quarter. The $1 million decrease in sales was due to lower coated bleached board shipments, partially offset by higher coated bleached board prices and higher newsprint shipments.

The US dollar reference price for coated bleached board was unchanged quarter-over-quarter. Currency was a positive factor as the Canadian dollar averaged US $0.751, a 2.1% decrease from US $0.767 in the prior quarter. Overall, average selling prices for coated bleached board were up $22 per tonne increasing adjusted EBITDA by $1 million. The coated bleached board shipment to capacity ratio was 101% compared to 107% in the prior quarter. Manufacturing costs increased by $2 million. Finished goods inventories of coated bleached board were at approximately 56 days of supply at the end of the December 2016 quarter, compared to 59 days at the end of the September 2016 quarter.

The US dollar benchmark price for newsprint was unchanged quarter-over-quarter. The previously noted decline in the relative value of the Canadian dollar favourably impacted price realizations, but this was partially offset by a less favourable sales mix. Overall, average selling prices for newsprint increased by $2 per tonne and did not impact adjusted EBITDA. The newsprint shipment to capacity ratio was 82% compared to 78% in the prior quarter. Costs were similar to the prior quarter. Finished goods inventories of newsprint were at approximately 19 days of supply at the end of the December 2016 quarter, compared to 15 days at the end of the September 2016 quarter.

The Paper segment generated operating earnings of $16 million, compared to operating earnings of $17 million in the September 2016 quarter. The previously noted decrease in adjusted EBITDA led to the lower operating profitability, partially offset by a $1 million decrease in depreciation expense.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

SEGMENT RESULTS – CORPORATE

	September 2016	**December 2016**
Financial ($ millions)		
General and administrative expenses	6	**5**
Share-based compensation	(1)	**4**
Depreciation and amortization	1	**-**
Other items:		
Custodial - idled facilities	1	**1**
Settlement gain - pension plan	(1)	**-**
Operating loss	6	**10**

The Company recorded a $4 million expense for share-based compensation in the December 2016 quarter compared to a $1 million credit in 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 and the September 2016 quarter.

The September 2016 quarter includes a settlement gain of $1 million related to a legacy defined benefit pension plan.

INTEREST, FOREIGN EXCHANGE AND OTHER

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

	$ millions	
	September 2016	**December 2016**
Interest on debt	15	**15**
Amortization of financing costs	1	**2**
Interest income	(1)	**-**
Foreign exchange items	-	**(3)**
Employee future benefits	2	**1**
Bank charges and other	1	**1**
	18	**16**

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. The increase of $1 million was due to a US $12 million term debt prepayment that occurred in the December 2016 quarter. 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.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

TRANSLATION OF FOREIGN DEBT

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.

During the September 2016 quarter, the Company recorded a loss of $8 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.769 to US $0.759.

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	
	September 2016	**December 2016**
Earnings (loss) before income taxes	16	**(11)**
Anticipated income tax expense (recovery)	4	**(3)**
Recognition of previously unrecognized tax assets	(2)	**(5)**
Decrease in income tax rates	-	**5**
Non-deductible portion of foreign exchange loss on long-term debt	1	**2**
Permanent differences and other tax adjustments	1	**(1)**
Income tax expense (recovery)	4	**(2)**

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 difference and other tax adjustments increased the income tax recovery by $1 million.

During the September 2016 quarter, the Company recorded an income tax expense of $4 million on earnings before income taxes of $16 million. While the overall expense was as anticipated, it included several offsetting items. The income tax expense decreased by $2 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-deductible portion of the foreign exchange loss on translation of debt increased the income tax expense by $1 million. Permanent difference and other tax adjustments increased the income tax expense by $1 million.

DECEMBER 2016 QUARTER VS SEPTEMBER 2016 QUARTER

NET EARNINGS (LOSS)

The Company generated net loss of $9 million or $0.09 per share for the quarter ended December 24, 2016. This compares to net earnings of $12 million or $0.12 per share for the quarter ended September 24, 2016.

COMPREHENSIVE EARNINGS

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

	$ millions	
	September 2016	**December 2016**
Net earnings (loss)	12	**(9)**
Employee future benefit gain	5	**50**
Income tax expense	-	**(2)**
Foreign currency translation gain (loss) on foreign operations	5	**(10)**
Total comprehensive earnings	22	**29**

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.

During the September 2016 quarter, the Company recognized a gain of $5 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 $20 million. The average discount rate applied to estimate the present value of future obligations decreased from 3.44% to 3.24%, thereby increasing the net obligation by $22 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 and plan experience reduced the net obligation by $6 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 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. During the September 2016 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.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

CONSOLIDATED SUMMARY

SALES

$ millions	December 2015	**December 2016**	Total Variance	Price Variance	Volume & Mix Variance
Forest Products	110	**113**	3	10	(7)
Specialty Cellulose Pulp	109	**103**	(6)	(3)	(3)
Paper Pulp	68	**83**	15	5	10
Paper	94	**96**	2	-	2
Corporate	1	**1**	-	-	-
	382	**396**	14	12	2
Less: Intersegment Sales	(28)	**(26)**	2		
Sales	354	**370**	16		

Sales increased by $16 million from the same quarter a year ago. Currency was not a significant factor as the Canadian dollar averaged US $0.751, similar to US $0.749 in the year ago quarter. Forest Products segment sales increased by $3 million as a result of higher lumber prices, partially offset by lower lumber shipments. Specialty Cellulose Pulp segment sales decreased by $6 million due to lower prices and shipments. Paper Pulp segment sales increased by $15 million due to higher shipments and prices. Paper segment sales increased by $2 million due to higher shipments of coated bleached board.

ADJUSTED EBITDA

$ millions	December 2015	**December 2016**	Total Variance	Price Variance	Cost & Volume Variance
Forest Products	(1)	**9**	10	10	-
Specialty Cellulose Pulp	19	**10**	(9)	(3)	(6)
Paper Pulp	(2)	**7**	9	5	4
Paper	16	**17**	1	-	1
Corporate	(3)	**(9)**	(6)	-	(6)
	29	**34**	5	12	(7)

Adjusted EBITDA increased by $5 million from the prior year quarter. Forest Products segment adjusted EBITDA increased by $10 million due to higher prices. Specialty Cellulose Pulp segment adjusted EBITDA decreased by $9 million due to higher costs and lower prices. Paper Pulp segment adjusted EBITDA increased by $9 million due to lower costs and higher prices. Paper segment adjusted EBITDA increased by $1 million due to lower costs. Corporate costs increased by $6 million primarily due to share-based compensation expense.

OPERATING EARNINGS (LOSS)

$ millions	December 2015	**December 2016**	Total Variance	Adjusted EBITDA Variance	Depreciation Variance	Other Items Variance
Forest Products	(2)	**8**	10	10	-	-
Specialty Cellulose Pulp	12	**3**	(9)	(9)	-	-
Paper Pulp	(5)	**4**	9	9	-	-
Paper	15	**16**	1	1	-	-
Corporate	(4)	**(10)**	(6)	(6)	-	-
	16	**21**	5	5	-	-

The Company generated operating earnings of $21 million compared to operating earnings of $16 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.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

SEGMENT RESULTS – FOREST PRODUCTS

	December 2015	**December 2016**	Variance
Financial ($ millions)			
Sales - SPF Lumber	80	**83**	3
Sales - Chips, logs and other[1]	30	**30**	-
	110	**113**	3
Freight and other deductions	12	**11**	1
Cost of sales	96	**90**	6
SG&A	3	**3**	-
Adjusted EBITDA	(1)	**9**	10
Depreciation and amortization	1	**1**	-
Operating earnings (loss)	(2)	**8**	10
Shipments			
SPF lumber (mmbf)	197	**179**	(18)
Benchmark Prices			
KD #2 & better delivered G.L. (US $ per mbf)	363	**403**	40
KD stud delivered G.L. (US $ per mbf)	299	**360**	61

(1) Includes intersegment sales eliminated on consolidation

The Forest Products segment generated adjusted EBITDA of $9 million on sales of $113 million. This compares to negative adjusted EBITDA of $1 million on sales of $110 million in the comparable quarter of the prior year. The $3 million increase in SPF lumber sales was due to higher lumber prices, partially offset by lower shipments.

US dollar benchmark price for random lumber increased by US $40 per mbf while the benchmark price for stud lumber was up US $61 per mbf. Currency was not a significant factor as the Canadian dollar averaged US $0.751 versus US $0.749 in the year ago quarter. Overall, Canadian dollar selling prices increased by $57 per mbf, increasing adjusted EBITDA by $10 million. Lumber shipments were equal to 95% of capacity, compared to 92% in the year ago quarter. The December 2015 quarter capacity included the Senneterre sawmill. The current quarter does not include the capacity of the Senneterre sawmill. The delivered cash cost of SPF lumber declined by $1 million.

The Forest Products segment generated operating earnings of $8 million, as compared to an operating loss of $2 million in the prior year quarter. 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.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

SEGMENT RESULTS – SPECIALTY CELLULOSE PULP

	December 2015	**December 2016**	Variance
Financial ($ millions)			
Sales - Pulp	88	**84**	(4)
Sales - Chemicals	21	**19**	(2)
	109	**103**	(6)
Freight and other deductions	10	**9**	1
Cost of sales	75	**80**	(5)
SG&A	5	**4**	1
Adjusted EBITDA	19	**10**	(9)
Depreciation and amortization	7	**7**	-
Operating earnings	12	**3**	(9)
Pulp shipments			
Specialty grades (000's tonnes)	41	**46**	5
Viscose and other grades (000's tonnes)	21	**10**	(11)
	62	**56**	(6)
Average prices			
Specialty grades (C $ per tonne)	1,575	**1,528**	(47)
Viscose and other grades (C $ per tonne)	1,118	**1,285**	167

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $10 million on sales of $103 million. This compares to adjusted EBITDA of $19 million on sales of $109 million in the year ago quarter. The $4 million decrease in pulp sales was due to lower shipments of viscose and other grades, partially offset by higher shipments of specialty grades. Chemical sales declined by $2 million due to lower prices.

US dollar and euro prices for specialty grade pulp declined by approximately 2% from the year ago quarter. Currency was not a significant factor as the relative value of the Canadian dollar versus the US dollar and the euro was comparable. Canadian dollar equivalent pricing for specialty grades declined by $47 per tonne. The $167 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 partially offset the lower specialty prices and the impact on adjusted EBITDA was a decrease of $1 million. Shipments were equal to 73% of capacity as compared to 80% in the prior year 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. Tartas had no major maintenance downtime in the prior year quarter. As a result, the pulp mill produced 8,300 fewer tonnes in the December 2016 quarter. Manufacturing costs increased by $9 million, including $5 million for maintenance material and $3 million of unabsorbed fixed costs associated with the aforementioned productivity decrease. The higher proportion of specialty grades generated a favourable $2 million mix variance. Chemical business adjusted EBITDA declined by $1 million due to lower selling prices.

The Specialty Cellulose Pulp segment generated operating earnings of $3 million as compared to operating earnings of $12 million in the prior year quarter. The previously noted decrease in adjusted EBITDA led to the decline in operating results.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

SEGMENT RESULTS – PAPER PULP

	December 2015	**December 2016**	Variance
Financial ($ millions)			
Sales [(1)]	68	**83**	15
Freight and other deductions	14	**16**	(2)
Cost of sales	55	**59**	(4)
SG&A	1	**1**	-
Adjusted EBITDA	(2)	**7**	9
Depreciation and amortization	3	**3**	-
Operating earnings (loss)	(5)	**4**	9
Shipments			
High-yield pulp (000's tonnes)	100	**120**	20
Internal (000's tonnes)	18	**15**	(3)
Total	118	**135**	17
Benchmark Prices			
BEK - delivered China (US $ per tonne)	627	**513**	(114)

(1) Includes intersegment sales eliminated on consolidation

The Paper Pulp segment generated adjusted EBITDA of $7 million on sales of $83 million. This compares to negative adjusted EBITDA of $2 million on sales of $68 million in the year ago quarter. The $15 million increase in sales was caused by higher shipments and prices.

The benchmark price for BEK decreased by US $114 per tonne. The high-yield pulp market did not follow this trend and the US dollar selling prices increased by US $25 per tonne. Currency was not a significant factor as the relative value of the Canadian dollar versus the US dollar was comparable. As a result, Canadian dollar prices for external high-yield pulp sales increased by $31 per tonne, increasing adjusted EBITDA by $5 million. Pulp shipments were equal to 95% of capacity as compared to 83% in the year ago quarter. The December 2015 quarter results included 33 days of market downtime at the Temiscaming pulp mill due to weak demand and market conditions. There was no market downtime in the December 2016 quarter and the mill produced 21,700 more tonnes. Manufacturing costs declined by $3 million, primarily as a result of higher fixed absorption related to the aforementioned productivity increase. Cost at the Matane pulp mill also declined by $2 million.

The Paper Pulp segment generated operating earnings of $4 million compared to an operating loss of $5 million in the comparable quarter of the prior year. The previously noted increase in adjusted EBITDA led to the improvement in operating results.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

SEGMENT RESULTS – PAPER

	December 2015	**December 2016**	Variance
Financial ($ millions)			
Sales	94	**96**	2
Freight and other deductions	11	**10**	1
Cost of sales	65	**66**	(1)
SG&A	2	**3**	(1)
Adjusted EBITDA	16	**17**	1
Depreciation and amortization	1	**1**	-
Operating earnings	15	**16**	1
Shipments			
Coated bleached board (000's tonnes)	41	**46**	5
Newsprint (000's tonnes)	54	**45**	(9)
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)	505	**575**	70

The Paper segment generated adjusted EBITDA of $17 million on sales of $96 million. This compares to adjusted EBITDA of $16 million on sales of $94 million in the same quarter a year ago. The $2 million increase in sales was due to higher coated bleached board shipments, partially offset by lower newsprint shipments.

The US dollar benchmark price for coated bleached board decreased by US $20 per short ton. Currency was not a significant factor as the Canadian dollar averaged US $0.751, similar to US $0.749 in the year ago quarter. Overall, average selling prices for coated bleached board declined by $44 per tonne, decreasing adjusted EBITDA by $2 million. The coated bleached board shipment to capacity ratio was 101% compared to 90% 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 $70 per tonne. The higher US dollar prices were partially offset by a weaker sales mix and Canadian dollar prices increased by $42 per tonne, increasing adjusted EBITDA by $2 million. The newsprint shipment to capacity ratio was 82%, compared to 98% in the year ago quarter. Mill costs were similar to those of the year ago quarter.

The Paper segment generated operating earnings of $16 million, as compared to operating earnings of $15 million in the prior year quarter. The increase in adjusted EBITDA led to the improvement in operating results.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

SEGMENT RESULTS – CORPORATE

	December 2015	**December 2016**
Financial ($ millions)		
General and administrative expenses	4	**5**
Share-based compensation	(1)	**4**
Other items:		
Custodial - idled facilities	1	**1**
Operating loss	4	**10**

The Company recorded a $4 million expense for share-based compensation in the December 2016 quarter, as compared to a $1 million credit 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.

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 and the December 2015 quarters.

INTEREST, FOREIGN EXCHANGE AND OTHER

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

	$ millions	
	December 2015	**December 2016**
Interest on debt	15	**15**
Amortization of financing costs	1	**2**
Foreign exchange items	(1)	**(3)**
Employee future benefits	1	**1**
Bank charges and other	1	**1**
	17	**16**

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. The increase of $1 million was due to a US $12 million term debt prepayment that occurred in the December 2016 quarter. 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 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.

During the December 2015 quarter, the Company recorded a loss of $24 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.751 to US $0.722.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

INCOME TAXES

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

	$ millions	
	December 2015	**December 2016**
Loss before income taxes	(25)	**(11)**
Anticipated income tax recovery	(6)	**(3)**
Recognition of previously unrecognized tax asset	-	**(5)**
Decrease in income tax rates	-	**5**
Difference in statutory rates	1	**-**
Unrecognized tax asset	4	**-**
Non-deductible portion of foreign exchange loss on long-term debt	3	**2**
Permanent differences and other tax adjustments	1	**(1)**
Income tax expense (recovery)	3	**(2)**

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.

During the December 2015 quarter, the Company recorded an income tax expense of $3 million on a loss before income taxes of $25 million. The income tax expense reflected a $9 million unfavourable variance versus an anticipated income tax recovery of $6 million based on the Company's effective tax rate of 26.2%. The difference in statutory income tax rates increased the income tax expense by $1 million. This was caused by the higher corporate tax rate applicable to the Company's French operations. The income tax expense was increased by $4 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. The non-deductible portion of the foreign exchange loss on translation of debt increased the income tax expense by $3 million. Permanent differences and other tax adjustments increased the income tax expense by $1 million.

NET LOSS

The Company generated a net loss of $9 million or $0.09 per share for the quarter ended December 24, 2016, compared to a net loss of $28 million or $0.28 per share for the quarter ended December 26, 2015.

DECEMBER 2016 QUARTER VS DECEMBER 2015 QUARTER

COMPREHENSIVE EARNINGS (LOSS)

The following table summarizes the impact of items affecting the reported total comprehensive earnings (loss) during the December 2016 quarter and the comparable quarter a year ago:

	$ millions	
	December 2015	**December 2016**
Net loss	(28)	**(9)**
Employee future benefit gain	9	**50**
Income tax expense	-	**(2)**
Foreign currency translation gain (loss) on foreign operations	3	**(10)**
Total comprehensive earnings (loss)	(16)	**29**

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.

During the December 2015 quarter, the Company recognized a gain of $9 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, reducing the net obligation by $14 million. The average discount rate applied to estimate the present value of future obligations decreased from 4.04% to 4.01%, thereby increasing the net obligation by $5 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 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. During the December 2015 quarter, the currency translation of the French operations generated a gain of $4 million. The currency translation of the U.S. operations generated a loss of $1 million.

SELECTED QUARTERLY INFORMATION

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

	$ millions (except as otherwise noted)							
	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	**Dec 16**
Sales	348	365	373	354	380	376	389	**370**
Adjusted EBITDA	12	2	36	29	36	26	57	**34**
Depreciation and amortization	10	12	12	12	13	13	15	**12**
Other items expense (credit)	(8)	1	-	1	-	(5)	-	**1**
Operating earnings (loss)	10	(11)	24	16	23	18	42	**21**
Net earnings (loss)	(40)	(16)	(32)	(28)	27	9	12	**(9)**
Basic and fully diluted net earnings (loss) per share ($)	(0.40)	(0.16)	(0.32)	(0.28)	0.27	0.09	0.12	**(0.09)**
Comprehensive earnings (loss)	(43)	5	(29)	(16)	(10)	(8)	22	**29**

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**	-	-	-
Less:								
Additions to property, plant and equipment	10	7	10	17	**10**	-	-	-
Interest on debt	15	16	15	15	**15**	-	-	-
Free cash flow (negative)	(3)	12	(4)	16	**9**	-	-	-

Cash flow from operations before working capital changes for the first quarter of fiscal 2017 was $34 million, compared to $22 million in the prior year. The $5 million increase in adjusted EBITDA, which included a $5 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 $10 million and interest on debt of $15 million, free cash flow for the first quarter of fiscal 2017 was $9 million compared to negative $3 million in the prior year quarter.

FINANCIAL POSITION

CAPITAL EXPENDITURES

The following table summarizes capital expenditures by segment:

	Quarters ended	
$ millions	December 2015	**December 2016**
Forest Products	2	**3**
Specialty Cellulose Pulp	5	**3**
Paper Pulp	2	**2**
Paper	1	**2**
	10	**10**

During the first quarter of fiscal 2017, capital expenditures totalled $10 million, unchanged from the prior year quarter. There were no significant large projects under construction in either period.

LIQUIDITY

The Company has set an objective of maintaining a minimum liquidity of $135 million to $150 million. As at December 24, 2016, the Company had total cash, including restricted cash, of $45 million plus unused operating lines of $106 million, for total liquidity of $151 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**
Borrowing base	190	**186**
Less: fixed availability reserves	(31)	**(15)**
Less: variable availability reserves	-	**-**
Net availability	159	**171**
Outstanding letters of credit	(45)	**(45)**
Amount drawn	(12)	**(20)**
Unused amount	102	**106**

At the end of September 2015, the Company had a $175 million ABL facility expiring in March 2018. The ABL facility was refinanced on November 18, 2015. The ABL consists of a $150 million revolving credit facility (revolving loan) and a US $62 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 original maturity date of March 2, 2018. In the December 2016 quarter, the Company and the ABL lenders agreed to extend the maturity of the FILO loan to 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 has been 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 December 2016 quarter was $68 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 December 2016 quarter, an amount of $133 million was available on the revolver portion of the ABL and an amount of $17 million was drawn on the facility.

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 December 2016 quarter, there were $11 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 December 2016 quarter, an amount of $27 million was available and an amount of $3 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 / LTM (last twelve months) adjusted EBITDA (times)	9.8	7.4	5.6	4.6	**4.5**	-	-	-
LTM adjusted EBITDA / LTM interest on indebtedness (times)	1.4	1.8	2.1	2.4	**2.5**	-	-	-
Net debt / total capitalization (%)	78%	77%	76%	74%	**74%**	-	-	-

The Company has set certain objectives relating to its level of indebtedness. The Company's long-term objectives are to 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 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 capital expenditures in the near term, the focus will be 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. A significant portion of the proceeds was utilized to purchase and redeem US $305 million – 11.25% senior secured notes, in addition to paying US $10 million of accrued interest and an early prepayment penalty of US $24 million. 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 December 2016, the Company had repaid $4 million of the principal related to the term loan and $36 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

Moody's Investors Service (Moody's) has assigned a B3 rating to the 9% senior secured notes and the same level for the Company's corporate credit rating. Moody's has a "negative" outlook with respect to its rating. 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 January 26, 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 December 24, 2016, 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.

OUTLOOK

Overall, the December 2016 quarterly results were as anticipated. The $13 million adjusted EBITDA decrease in the Specialty Cellulose segment was expected due to significant planned major maintenance. The 11-day maintenance outage at the Tartas specialty pulp mill cost more than originally forecast due to additional repairs on the biomass boiler. Higher viscose prices combined with a weaker Canadian dollar had a positive impact on Canadian dollar selling prices. A significant rebound in profitability in the March 2017 quarter is expected. Non-acetate specialty grade prices will increase by 5% to 7% and there will be no planned major maintenance in the quarter at either of the two specialty pulp mills. Lumber markets continued to show "late season" strength and prices were relatively robust during what is normally a slow period. Lumber market fundamentals should continue to gradually improve over time. The Paper Pulp segment results were better than anticipated. The market reacted positively to the news that a large BEK expansion project would be ramping up at a slower rate than initially expected. However, this new capacity will eventually occur, putting pressure on the hardwood pulp market. The Paper segment adjusted EBITDA of $17 million represented another solid quarter for this segment and it should continue to perform well. With trailing twelve-month adjusted EBITDA having reached $153 million, the Company has been able to demonstrate the positive impact on margins generated by the Temiscaming Cogen project as well as other cost reduction initiatives. The Company will continue to focus on cost and working capital reductions with a goal of further improving operating results and reducing the Company's overall level of indebtedness.

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**	-	-	-
Book value per share ($)		0.55	0.45	0.37	0.59	**0.88**	-	-	-
Foreign exchange:									
1 C $ = US $	- average	0.749	0.727	0.776	0.767	**0.751**	-	-	-
	- period end	0.722	0.755	0.769	0.759	**0.739**	-	-	-
1 euro = US $	- average	1.094	1.101	1.131	1.116	**1.083**	-	-	-
	- period end	1.095	1.117	1.108	1.123	**1.045**	-	-	-
1 euro = C $	- average	1.460	1.515	1.457	1.455	**1.443**	-	-	-
	- period end	1.516	1.480	1.441	1.479	**1.414**	-	-	-

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**	-	-	-
Depreciation and amortization	12	13	13	15	**12**	-	-	-
Other items expense (credit)	1	-	(5)	-	**1**	-	-	-
Adjusted EBITDA	29	36	26	57	**34**	-	-	-

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**	-	-	-
Long-term debt	711	685	689	679	**694**	-	-	-
Net unamortized financing costs [1]	25	23	21	20	**19**	-	-	-
Current portion of long-term debt	14	16	6	22	**6**	-	-	-
Less: cash, cash equivalents and restricted cash	(43)	(43)	(47)	(46)	**(45)**	-	-	-
Net debt	776	758	712	682	**689**	-	-	-
Long-term liabilities [2]	158	178	188	183	**149**	-	-	-
Shareholders' equity	55	45	37	59	**88**	-	-	-
Total capitalization	989	981	937	924	**926**	-	-	-
Net debt to total capitalization ratio	78%	77%	76%	74%	**74%**	-	-	-

(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**	-	-	-
LTM adjusted EBITDA	79	103	127	148	**153**	-	-	-
Net debt to LTM adjusted EBITDA (times)	9.8	7.4	5.6	4.6	**4.5**	-	-	-

TEMBEC INC.
CONSOLIDATED BALANCE SHEETS

(unaudited) (in millions of Canadian dollars)

		Dec. 24, 2016		Sept. 24, 2016
ASSETS				
Current assets:				
Cash and cash equivalents	$	43	$	44
Restricted cash		2		2
Trade and other receivables		137		153
Inventories (note 3)		267		273
Prepaid expenses		9		9
Assets classified as held for sale (note 4)		-		10
		458		491
Property, plant and equipment (note 5)		633		639
Biological assets		3		3
Employee future benefits		37		23
Other long-term receivables		2		2
Deferred tax assets		3		2
	$	1,136	$	1,160
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Operating bank loans (note 6)	$	15	$	7
Trade, other payables and accrued charges		180		193
Interest payable		2		13
Provisions		2		4
Current portion of long-term debt (note 7)		6		22
Liabilities classified as held for sale (note 4)		-		1
		205		240
Long-term debt (note 7)		694		679
Provisions		12		12
Employee future benefits		136		169
Other long-term liabilities		1		1
		1,048		1,101
Shareholders' equity:				
Share capital (note 8)		568		568
Accumulated other comprehensive earnings		5		15
Deficit		(485)		(524)
		88		59
	$	1,136	$	1,160

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

TEMBEC INC.
CONSOLIDATED STATEMENTS OF NET EARNINGS (LOSS)

Quarters ended December 24, 2016 and December 26, 2015
(unaudited) (in millions of Canadian dollars, unless otherwise noted)

	Quarters ended	
	Dec. 24, 2016	Dec. 26, 2015
Sales	**$ 370**	$ 354
Freight and other deductions	**46**	47
Cost of sales (excluding depreciation and amortization)	**270**	264
Selling, general and administrative	**16**	15
Share-based compensation	**4**	(1)
Depreciation and amortization	**12**	12
Other items (note 9)	**1**	1
Operating earnings	**21**	16
Interest, foreign exchange and other	**16**	17
Foreign exchange loss on long-term debt	**16**	24
Net finance costs (note 10)	**32**	41
Loss before income taxes	**(11)**	(25)
Income tax expense (recovery) (note 11)	**(2)**	3
Net loss	**$ (9)**	$ (28)
Basic and diluted net loss in dollars per share (note 8)	**$ (0.09)**	$ (0.28)

TEMBEC INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS (LOSS)

Quarters ended December 24, 2016 and December 26, 2015
(unaudited) (in millions of Canadian dollars)

	Quarters ended	
	Dec. 24, 2016	Dec. 26, 2015
Net loss	**$ (9)**	$ (28)
Other comprehensive earnings, net of income taxes:		
Items that will never be reclassified to earnings (loss):		
Defined benefit pension plans and other benefit plans (note 12)	**50**	9
Income tax expense	**(2)**	-
	48	9
Item that may be reclassified to earnings (loss) in future periods:		
Foreign currency translation differences for foreign operations	**(10)**	3
Other comprehensive earnings	**38**	12
Total comprehensive earnings (loss)	**$ 29**	$ (16)

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

TEMBEC INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS’ EQUITY

Quarters ended December 24, 2016 and December 26, 2015
(unaudited) (in millions of Canadian dollars)

					Quarter ended December 24, 2016			
		Share capital		**Translation of foreign operations**		**Deficit**		**Shareholders' equity**
Balance - beginning of period	**$**	**568**	**$**	**15**	**$**	**(524)**	**$**	**59**
Net loss for the period		**-**		**-**		**(9)**		**(9)**
Other comprehensive earnings (loss), net of income taxes:								
Defined benefit pension plans and other benefit plans (note 12)		**-**		**-**		**50**		**50**
Income tax expense		**-**		**-**		**(2)**		**(2)**
Foreign currency translation differences for foreign operations		**-**		**(10)**		**-**		**(10)**
Balance - end of period	**$**	**568**	**$**	**5**	**$**	**(485)**	**$**	**88**

					Quarter ended December 26, 2015			
		Share capital		Translation of foreign operations		Deficit		Shareholders' equity
Balance - beginning of period	$	568	$	16	$	(513)	$	71
Net loss for the period		-		-		(28)		(28)
Other comprehensive earnings (loss), net of income taxes:								
Defined benefit pension plans and other benefit plans (note 12)		-		-		9		9
Foreign currency translation differences for foreign operations		-		3		-		3
Balance - end of period	$	568	$	19	$	(532)	$	55

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

TEMBEC INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

Quarters ended December 24, 2016 and December 26, 2015
(unaudited) (in millions of Canadian dollars)

	Quarters ended Dec. 24, 2016	Dec. 26, 2015
Cash flows from operating activities:		
Net loss	**$ (9)**	$ (28)
Adjustments for:		
Depreciation and amortization	**12**	12
Net finance costs (note 10)	**32**	41
Income tax expense (recovery) (note 11)	**(2)**	3
Income tax paid	**(2)**	(2)
Difference between cash contributions and employee future benefits expense	**1**	(1)
Share-based compensation	**4**	(1)
Other	**(2)**	(2)
	34	22
Changes in non-cash working capital:		
Trade and other receivables	**13**	12
Inventories	**6**	(4)
Trade, other payables and accrued charges	**(10)**	(5)
	9	3
	43	25
Cash flows used in investing activities:		
Disbursements for property, plant and equipment	**(14)**	(11)
Proceeds from sale of Senneterre sawmill (note 4)	**8**	-
Change in restricted cash	**-**	(8)
	(6)	(19)
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	**7**	(2)
Increase in long-term debt (note 7)	**-**	78
Repayments of long-term debt (note 7)	**(17)**	(1)
Interest paid	**(26)**	(25)
	(36)	6
	1	12
Foreign exchange loss on cash and cash equivalents held in foreign currencies	**(2)**	-
Net increase (decrease) in cash and cash equivalents	**(1)**	12
Cash and cash equivalents, beginning of period	**44**	21
Cash and cash equivalents, end of period	**$ 43**	$ 33

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

TEMBEC INC.
CONSOLIDATED BUSINESS SEGMENT INFORMATION

Quarters ended December 24, 2016 and December 26, 2015
(unaudited) (in millions of Canadian dollars)

Quarter ended December 24, 2016

	Forest Products	Specialty Cellulose	Paper Pulp	Paper	Corporate	Consolidation adjustments	Consolidated
Sales:							
External	**$ 96**	**$ 103**	**$ 75**	**$ 96**	**$ -**	**$ -**	**$ 370**
Internal	**17**	**-**	**8**	**-**	**1**	**(26)**	**-**
	113	**103**	**83**	**96**	**1**	**(26)**	**370**
Freight and other deductions	**11**	**9**	**16**	**10**	**-**	**-**	**46**
Cost of sales	**90**	**80**	**59**	**66**	**1**	**(26)**	**270**
Selling, general and administrative	**3**	**4**	**1**	**3**	**5**	**-**	**16**
Share-based compensation	**-**	**-**	**-**	**-**	**4**	**-**	**4**
Earnings (loss) before the following (adjusted EBITDA):	**9**	**10**	**7**	**17**	**(9)**	**-**	**34**
Depreciation and amortization	**1**	**7**	**3**	**1**	**-**	**-**	**12**
Other items (note 9)	**-**	**-**	**-**	**-**	**1**	**-**	**1**
Operating earnings (loss)	**$ 8**	**$ 3**	**$ 4**	**$ 16**	**$ (10)**	**$ -**	**$ 21**
Additions to property, plant and equipment	**$ 3**	**$ 3**	**$ 2**	**$ 2**	**$ -**	**$ -**	**$ 10**
Total assets	**$ 153**	**$ 672**	**$ 128**	**$ 152**	**$ 31**	**$ -**	**$ 1,136**
Total liabilities	**$ 43**	**$ 266**	**$ 31**	**$ 74**	**$ 634**	**$ -**	**$ 1,048**

Quarter ended December 26, 2015

	Forest Products	Specialty Cellulose	Paper Pulp	Paper	Corporate	Consolidation adjustments	Consolidated
Sales:							
External	$ 93	$ 108	$ 59	$ 94	$ -	$ -	$ 354
Internal	17	1	9	-	1	(28)	-
	110	109	68	94	1	(28)	354
Freight and other deductions	12	10	14	11	-	-	47
Cost of sales	96	75	55	65	1	(28)	264
Selling, general and administrative	3	5	1	2	4	-	15
Share-based compensation	-	-	-	-	(1)	-	(1)
Earnings (loss) before the following (adjusted EBITDA):	(1)	19	(2)	16	(3)	-	29
Depreciation and amortization	1	7	3	1	-	-	12
Other items (note 9)	-	-	-	-	1	-	1
Operating earnings (loss)	$ (2)	$ 12	$ (5)	$ 15	$ (4)	$ -	$ 16
Additions to property, plant and equipment	$ 2	$ 5	$ 2	$ 1	$ -	$ -	$ 10
Total assets	$ 152	$ 698	$ 145	$ 168	$ 32	$ -	$ 1,195
Total liabilities	$ 44	$ 254	$ 32	$ 76	$ 734	$ -	$ 1,140

(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 January 26, 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

	Dec. 24, 2016	Sept. 24, 2016
Finished goods	**$ 119**	$ 123
Logs and wood chips	**71**	72
Supplies and spare parts	**77**	78
	$ 267	$ 273
Inventories carried at net realizable value	**$ 8**	$ 24

Inventories at December 24, 2016, 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	
	Dec. 24, 2016	Sept. 24, 2016
Land	**$ 3**	$ 3
Buildings	**88**	89
Production equipment:		
Pulp and paper	**485**	493
Sawmill	**20**	20
Forest access roads	**11**	11
Assets under construction	**26**	23
	$ 633	$ 639

For the quarter ended December 24, 2016, the Company had additions to property, plant and equipment of $10 million.

6. Operating bank loans

	Dec. 24, 2016	Sept. 24, 2016
Operating bank loans - Canadian operations	**$ 17**	$ 10
Operating bank loans - French operations	**3**	2
	20	12
Less unamortized financing costs	**5**	5
	$ 15	$ 7

As at December 24, 2016, 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 $133 million of which $17 million was drawn and $34 million was reserved for letters of credit. Interest is calculated based on the Canadian base rate plus an applicable margin of 1.25% at the end of the December 2016 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 December 24, 2016, the amount available was $27 million, of which $3 million was drawn.

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

7. Long-term debt

	Maturity	Dec. 24, 2016	Sept. 24, 2016
Tembec Industries Inc. - US $375 million - 9% senior secured notes	12/2019	**$ 507**	$ 494
Tembec Industries Inc. - US $50 million (September 2016 - US $62 million) - LIBOR + 7.25% FILO term loan	09/2018	**68**	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	**18**	18
Tembec Tartas SAS	Various	**10**	10
Other	Various	**-**	1
		714	716
Less current portion		**6**	22
Less unamortized financing costs		**14**	15
		$ 694	$ 679

On October 18, 2016, the Company entered into an agreement to extend the maturity date of the FILO 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 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

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

Net loss per share

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

	Quarters ended Dec. 24, 2016	Quarters ended Dec. 26, 2015
Net loss	**$ (9)**	$ (28)
Weighted average number of common shares outstanding	**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
Basic and diluted net loss in dollars per share	**$ (0.09)**	$ (0.28)

(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 December 24, 2016, 3,173,852 DSUs are outstanding having a carrying value of $1 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. 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 December 24, 2016, 3,040,758 DSUs are outstanding having a carrying value of $5 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 ended	
	Dec. 24, 2016	Dec. 26, 2015
Corporate:		
Costs for permanently idled facilities	**$ 1**	$ 1

During the December 2016 quarter, the Company recorded a charge of $1 million (December 2015 - $1 million) relating to several permanently idled facilities. These costs relate to custodial, site security, legal, pension plans administration and remediation activities.

10. Net finance costs

	Quarters ended	
	Dec. 24, 2016	Dec. 26, 2015
Interest on long-term debt	**$ 15**	$ 14
Interest on short-term debt	**-**	1
Amortization of financing costs using the effective interest method	**2**	1
Bank charges and other financing expenses	**1**	1
Net foreign exchange gain, excluding exchange on long-term debt	**(3)**	(1)
Foreign exchange loss on long-term debt	**16**	24
Net interest cost on defined benefit plans	**1**	1
	$ 32	$ 41
Finance costs	**$ 35**	$ 42
Finance income	**(3)**	(1)
Net finance costs	**$ 32**	$ 41

(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 ended		
		Dec. 24, 2016		Dec. 26, 2015
Loss before income taxes	**$**	**(11)**	$	(25)
Income tax recovery based on combined federal and provincial income tax rates of 26.1% (Fiscal 2016 - 26.2%)	**$**	**(3)**	$	(6)
Increase (decrease) resulting from:				
Difference in statutory income tax rates		**-**		1
Unrecognized tax assets		**-**		4
Recognition of previously unrecognized tax assets		**(5)**		-
Deferred income tax adjustment due to rate enactment		**5**		-
Non-deductible portion of foreign exchange loss on long-term debt		**2**		3
Permanent differences and other tax adjustments		**(1)**		1
		1		9
Income tax expense (recovery)	**$**	**(2)**	$	3
Income taxes:				
Current	**$**	**1**	$	2
Deferred		**(3)**		1
Income tax expense (recovery)	**$**	**(2)**	$	3

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 ended		
		Dec. 24, 2016		Dec. 26, 2015
Defined benefit pension plans	**$**	**3**	$	2
Defined contribution and other retirement plans		**2**		2
Other benefit plans		**-**		-
Current service cost	**$**	**5**	$	4
Net interest cost	**$**	**1**	$	1

(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 ended	
	Dec. 24, 2016	Dec. 26, 2015
Actuarial gain (loss) - variation in discount rate	**$ 67**	$ (5)
Return on plan assets - excluding interest income	**(20)**	14
Actuarial gain (loss) - demographic assumptions	**2**	-
Effect of limit on recognition of assets / minimum funding requirement	**1**	-
	$ 50	$ 9

The actuarial gain on variation in discount rate recognized in the statement of comprehensive earnings (loss) for the period ended December 24, 2016, 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. The actual rate of return for the quarter was approximately minus 1.6% (annualized minus 6.4%), which is 2.4% lower than the amount recorded in interest income of 0.8% (annualized 3.2%).

13. Financial instruments

Fair value

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

	Dec. 24, 2016	Sept. 24, 2016
Operating bank loans:		
Carrying value	**$ 15**	$ 7
Fair value	**$ 20**	$ 12
Long-term debt:		
Carrying value	**$ 700**	$ 701
Fair value	**$ 680**	$ 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:

	Dec. 24, 2016	Sept. 24, 2016
Loans and receivables, other than cash, cash equivalents and restricted cash	**$ 138**	$ 154
Cash, cash equivalents and restricted cash	**$ 45**	$ 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 December 24, 2016, totalled $151 million (September 24, 2016 – $148 million).

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

						December 24, 2016
	Carrying amount	Contractual cash flows	Year 1	Years 2-3	Years 4-5	After 5 years
Secured loans	$ 691	$ 891	$ 61	$ 700	$ 43	$ 87
Unsecured loans	9	9	3	4	2	-
Operating bank loans	15	20	20	-	-	-
Trade and others	183	183	182	-	1	-
	$ 898	$ 1,103	$ 266	$ 704	$ 46	$ 87

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	**Dec. 24, 2016**	Sept. 24, 2016
Net debt / LTM adjusted EBITDA (times)	3 or less	**4.5**	4.6
LTM Adjusted EBITDA / LTM interest on indebtedness (times)	3 or more	**2.5**	2.4
Net debt / total capitalization (%)	40% or less	**74%**	74%

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

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