Management's Discussion and Analysis

as at November 25, 2016

The Management's Discussion and Analysis (MD&A) section provides a review of the significant developments and issues that influenced Tembec Inc.'s financial performance during the fiscal year ended September 24, 2016, as compared to the fiscal year ended September 26, 2015. The MD&A should be read in conjunction with the audited consolidated financial statements for the fiscal year ended September 24, 2016. 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 section "Use of non-IFRS financial measures".

The 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 this MD&A is as at November 25, 2016. Disclosure contained in this document is current to that date, unless otherwise stated.

Throughout the MD&A, "Tembec" or "Company" means Tembec Inc. and its consolidated subsidiaries. Tembec's operations consist of five reportable business segments: Forest Products, Specialty Cellulose Pulp, Paper Pulp, Paper and Corporate. On November 25, 2016, the Company had approximately 3,000 employees, as compared to approximately 3,250 at the same date a year ago. The Company operates manufacturing facilities in Quebec, Ontario, the state of Ohio, as well as in Southern France. Principal facilities are described in subsequent sections of the MD&A.

2016 vs. 2015

Financial summary

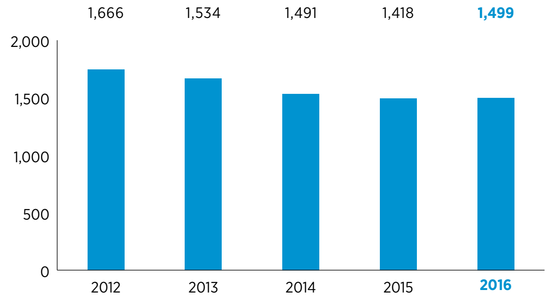
(in millions of dollars, unless otherwise noted)	2015	2016
Sales	1,418	1,499
Freight and other deductions	188	193
Lumber export taxes	2	–
Cost of sales (excluding depreciation and amortization)	1,102	1,097
SG&A	59	62
Share-based compensation	(3)	(1)
Adjusted EBITDA	70	148
Depreciation and amortization	43	53
Other items	(4)	(4)
Operating earnings	31	99
Interest, foreign exchange and other	54	75
Loss on refinancing of long-term debt	37	–
Foreign exchange loss (gain) on long-term debt	81	(6)
Earnings (loss) before income taxes	(141)	30
Income tax expense	9	10
Net earnings (loss)	(150)	20
Basic and diluted net earnings (loss) in dollars per share	(1.50)	0.20
Total comprehensive loss	(148)	(12)

Total assets (at year-end)	1,176	1,160
Total long-term debt (at year-end) (1)	624	701
Total long-term liabilities (at year-end)	775	861

(1) Includes current portion

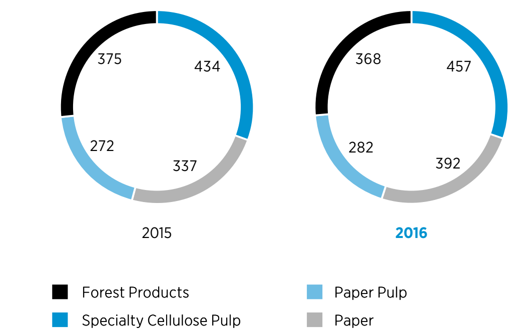
Consolidated sales

(in millions of dollars)



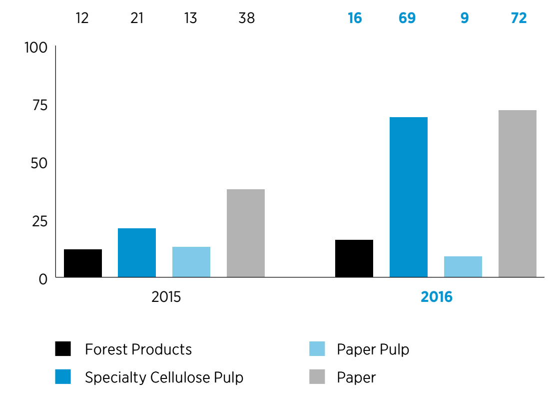
Consolidated sales by segment

(in millions of dollars)

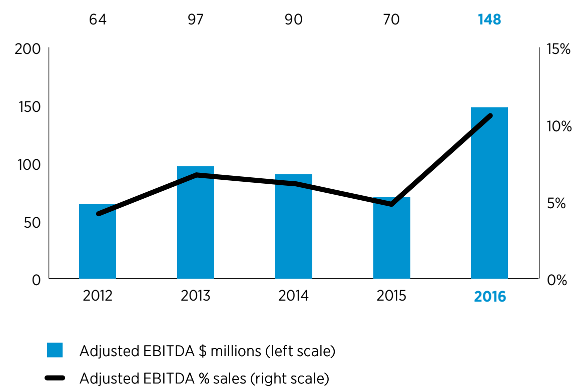


Adjusted EBITDA by segment

(in millions of dollars)



Financial performance



Fiscal 2012 results are not restated for IAS 19

Sales

(in millions of dollars)	2015	2016	Total variance	Price variance	Volume & mix variance
Forest Products	438	**433**	(5)	(4)	(1)
Specialty Cellulose Pulp	436	**462**	26	4	22
Paper Pulp	302	**314**	12	(18)	30
Paper	337	**392**	55	12	43
Corporate	9	**5**	(4)	–	(4)
	1,522	**1,606**	84	(6)	90
Less: intersegment sales	(104)	**(107)**	(3)		
Sales	1,418	**1,499**	81		

Sales increased by $81 million from the prior year. Currency was a positive factor as the Canadian dollar averaged US $0.754, a 7.7% decrease from US $0.817 in the prior year. Forest Products segment sales decreased by $5 million as a result of lower SPF lumber prices and shipments of hardwood lumber. Specialty Cellulose Pulp segment sales increased by $26 million due to higher shipments and prices. Paper Pulp segment sales increased by $12 million due to higher shipments, partially offset by lower prices. Paper segment sales increased by $55 million due to higher shipments and prices.

In terms of geographical distribution, the U.S. remained the Company's principal market with 37% of consolidated sales in fiscal 2016, as compared to 38% in the prior year. Canadian sales represented 19% of sales, compared to 20% in fiscal 2015. Sales outside of the U.S. and Canada represented the remaining 44% in fiscal 2016, as compared to 42% a year ago.

Adjusted EBITDA

(in millions of dollars)	2015	2016	Total variance	Price variance	Cost & volume variance
Forest Products	12	**16**	4	(4)	8
Specialty Cellulose Pulp	21	**69**	48	4	44
Paper Pulp	13	**9**	(4)	(18)	14
Paper	38	**72**	34	12	22
Corporate	(14)	**(18)**	(4)	–	(4)
	70	**148**	78	(6)	84

Adjusted EBITDA increased by $78 million from the prior year. Forest Products segment adjusted EBITDA increased by $4 million due to lower costs, partially offset by lower prices. Specialty Cellulose Pulp segment adjusted EBITDA increased by $48 million due to lower costs and higher prices. Paper Pulp segment adjusted EBITDA decreased by $4 million due to lower prices, partially offset by lower costs. Paper segment adjusted EBITDA increased by $34 million due to lower costs and higher prices. The increase in Corporate segment costs was partially due to higher short-term incentive plan accruals for corporate personnel. In addition, the prior year Corporate segment results included a $3 million credit related to share-based compensation as compared to a credit of $1 million in fiscal 2016.

Operating earnings (loss)

(in millions of dollars)	2015	**2016**	Total variance	Adjusted EBITDA variance	Depreciation variance	Other items variance
Forest Products	7	**9**	2	4	(2)	–
Specialty Cellulose Pulp	(1)	**41**	42	48	(6)	–
Paper Pulp	2	**(2)**	(4)	(4)	–	–
Paper	34	**66**	32	34	(2)	–
Corporate	(11)	**(15)**	(4)	(4)	–	–
	31	**99**	68	78	(10)	–

The Company generated operating earnings of $99 million compared to operating earnings of $31 million in fiscal 2015.

The Forest Products segment generated operating earnings of $9 million, as compared to operating earnings of $7 million in the prior year. The previously noted increase in adjusted EBITDA led to the improvement in operating results, partially offset by higher depreciation expense.

The Specialty Cellulose Pulp segment generated operating earnings of $41 million as compared to an operating loss of $1 million in the prior year. The previously noted improvement in adjusted EBITDA increased operating earnings. Depreciation expense increased by $6 million as the Company depreciated the new boiler and turbine at the Temiscaming specialty cellulose mill for the entire fiscal year. Fiscal 2015 results included only eight months of depreciation for the new boiler and turbine.

The Paper Pulp segment generated an operating loss of $2 million compared to operating earnings of $2 million in the prior year. The previously noted decrease in adjusted EBITDA led to the decline in operating results.

The Paper segment generated operating earnings of $66 million, as compared to operating earnings of $34 million in the prior year. The increase in adjusted EBITDA led to the higher operating profitability, partially offset by higher depreciation expense.

Corporate segment costs increased by $4 million, partially due to higher short-term incentive plan accruals for corporate personnel. Fiscal 2015 segment results included a $3 million credit related to share-based compensation as compared to a credit of $1 million in fiscal 2016.

A more detailed analysis of segment variances is included in the section that follows.

Segment review – 2016 vs. 2015

Forest Products

(in millions of dollars)	2015	2016
Sales [(1)]	438	**433**
Freight and other deductions	43	**42**
Lumber export taxes	2	**–**
Cost of sales	370	**363**
SG&A	11	**12**
Adjusted EBITDA	12	**16**
Adjusted EBITDA margin on sales	2.7%	**3.7%**
Depreciation and amortization	5	**7**
Operating earnings	7	**9**
Identifiable assets	159	**173**

[(1)] Includes intersegment sales eliminated on consolidation

The Forest Products segment is divided into two main areas of activity: forest resource management and manufacturing operations.

The Forest Resource Management group is responsible for managing all of the Company's Canadian forestry operations. This includes the harvesting of timber, either directly or by contractual agreements, and silviculture and regeneration work required to ensure a sustainable supply for the manufacturing units. The group is also responsible for third party timber purchases, which are needed to supplement total requirements. The group's main objective is the optimization of the flow of timber into various manufacturing units. As the Company's forest activity in Canada is conducted primarily on Crown lands, the Forest Resource Management group works closely with provincial governments to ensure harvesting plans and operations comply with established regulations and that stumpage charged by the provinces is reasonable and reflects the fair value of the timber being harvested. During fiscal 2016, the Company's operations harvested and delivered 3.1 million cubic metres of timber, unchanged from the prior year. Additional supply of approximately 0.9 million cubic metres was secured mainly through purchases and exchanges with third parties, compared to 0.7 million cubic metres in the prior year.

The Forest Products segment includes operations located in Quebec and Ontario. The SPF (spruce/pine/fir) lumber operations can produce approximately 755 million board feet of lumber per year. The specialty wood operations can annually produce 30 million board feet of hardwood lumber.

The following summarizes the current annual capacity of each facility by product group:

SPF lumber	**mbf**
Stud lumber – La Sarre, QC	135,000
Stud lumber – Cochrane, ON	160,000
Stud lumber – Kapuskasing, ON	105,000
Random lumber – Béarn, QC	110,000
Random lumber – Chapleau, ON	135,000
Random lumber – Hearst, ON	110,000
	755,000

Specialty wood	**mbf**
Hardwood lumber – Huntsville, ON	30,000

The aforementioned operations do not include the capacity of the Senneterre, Quebec, sawmill that was sold in October 2016. The sawmill sold 61 million board feet of stud lumber in fiscal 2016, compared to 91 million in fiscal 2015. The sawmill had been periodically idled during periods of low stud lumber prices in fiscal 2016.

The segment is dominated by SPF lumber, which represented 72% of total sales in fiscal 2016, unchanged from the prior year. The volume of SPF lumber sold in fiscal 2016 increased by 3.0 million board feet or 0.4%. Specialty wood represented 2% of total sales in fiscal 2016, down from 3% in the prior year. Wood chips and by-products accounted for 26% of total sales as compared to 25% in fiscal 2015.

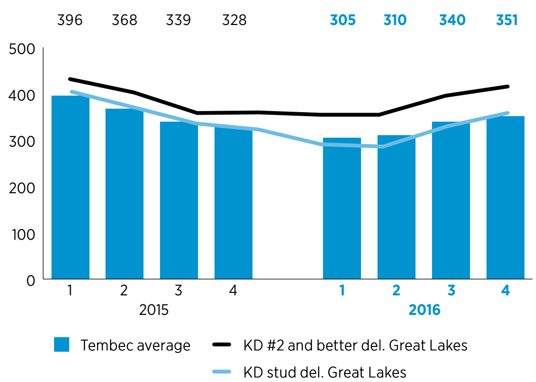
	Sales ($ millions)		Shipments (000 units)		Selling prices ($ / unit)	
	2015	**2016**	2015	**2016**	2015	**2016**
SPF lumber (mbf)	315	**312**	719.6	**722.6**	438	**432**
Specialty wood (mbf)	12	**9**	16.4	**11.5**	742	**806**
Wood chips (bone dry tonnes)	63	**59**	662.9	**655.3**	95	**90**
Logs and by-products	48	**53**				
Total sales	438	**433**				
Internal wood chips and other sales	(63)	**(65)**				
Consolidated sales	375	**368**				

The SPF sawmills produced and shipped 655,300 tonnes of wood chips in fiscal 2016, 72% of which were directed to the Company's pulp and paper operations. In 2015, the sawmills produced 662,900 tonnes and shipped 62% of this volume to the Company's pulp and paper mills. The internal transfer price of wood chips is based on comparable arms-length transactions.

Total sales for this segment reached $433 million, a decrease of $5 million over the prior year. After eliminating internal sales, the Forest Products segment generated 25% of Company consolidated sales, compared to 26% in the prior year. The segment's main market is North America, which represented 99% of consolidated sales in fiscal 2016, unchanged from the prior year.

Quarterly prices - Eastern SPF delivered

(US $ per mbf)



Markets

The Company markets its lumber with its own internal sales force.

The benchmark random length Eastern SPF average lumber price (#2 and better delivered Great Lakes) decreased from US $396 per mbf in fiscal 2015 to US $389 per mbf in fiscal 2016. The reference price for stud lumber decreased as well with the Eastern average lumber price (delivered Great Lakes) down from US $367 per mbf to US $324 per mbf. The price gap between the two grades was higher than historical averages. Currency provided a partial offset as the Canadian dollar averaged US $0.754, a 7.7% decline from US $0.817 in the prior year. As a result, the average selling price of SPF lumber decreased by $6 per mbf. Housing starts in the U.S. on a seasonally adjusted basis averaged 1,146,000 units in fiscal 2016, a 5.2% increase over the 1,089,000 units in fiscal 2015. However, these remained below the 1.2 million to 1.3 million average that would be indicative of normal market conditions. Housing starts in Canada on a seasonally adjusted basis averaged 198,000 units, a 3.7% increase when compared to 191,000 units in fiscal 2015. The SPF lumber shipment to capacity ratio was 85% in fiscal 2016, compared to 84% in the prior year. During fiscal 2016, the Company shipped 379,800 mbf or 52.6% of its volume into the U.S. market. The balance of 342,800 mbf or 47.4% of its volume was sold in Canada. In the prior year, the Company had shipped 382,200 mbf or 53.1% of its volume into the U.S. market. The balance of 337,400 mbf or 46.9% of its volume was sold in Canada.

Effective October 12, 2006, the governments of Canada and the United States implemented an agreement for the settlement of the softwood lumber dispute. The Softwood Lumber Agreement (SLA) required that an export tax be collected by the Government of Canada, which was based on the price and volume of lumber shipped. The SLA provided that during periods of relatively high prices, the export tax would decline or be completely eliminated. In fiscal 2015, the average tax rate on lumber shipped to the U.S. was 1.4% and the total cost was $2 million. The SLA expired on October 12, 2015, and the Company incurred a negligible charge related to lumber export taxes in fiscal 2016.

Operating results

The following summarizes adjusted EBITDA variances by major element:

	Variance – favourable (unfavourable)						
(in millions of dollars)	Price	Export taxes	Mill costs	Inventory NRV adjustments	Freight	Other	TOTAL
SPF lumber	(4)	2	5	3	–	(2)	4
Other segment items	–	–	–	–	–	–	–
	(4)	2	5	3	–	(2)	4

In fiscal 2016, adjusted EBITDA was $16 million compared to adjusted EBITDA of $12 million in the prior year. SPF lumber profitability increased by $4 million year-over-year. The previously noted lower Canadian dollar selling prices for lumber decreased adjusted EBITDA by $4 million. The decline in selling prices would have been more pronounced if not for the partial offset provided by the weaker Canadian dollar. The previously noted decrease in export taxes on lumber shipped to the U.S. increased adjusted EBITDA by $2 million. Sawmill manufacturing costs decreased by $5 million, primarily due to lower fibre costs. The segment adjusted EBITDA margin to total sales was 3.7% compared to 2.7% in the prior year.

The following summarizes operating results variances by major element:

(in millions of dollars)	2015	**2016**	Variance favourable (unfavourable)
Adjusted EBITDA	12	**16**	4
Depreciation and amortization	5	**7**	(2)
Operating earnings	7	**9**	2

The Forest Products segment generated operating earnings of $9 million, as compared to operating earnings of $7 million in fiscal 2015. The previously noted increase in adjusted EBITDA led to the improvement in operating results, partially offset by higher depreciation and amortization expense. The fiscal 2015 expense included the reversal of an asset impairment charge of $1 million.

Specialty Cellulose Pulp

(in millions of dollars)	2015	2016
Sales – Pulp [1]	333	**380**
Sales – Chemicals	103	**82**
	436	**462**
Freight and other deductions	43	**43**
Cost of sales	355	**333**
SG&A	17	**17**
Adjusted EBITDA	21	**69**
Adjusted EBITDA margin on sales	4.8%	**14.9%**
Depreciation and amortization	22	**28**
Operating earnings (loss)	(1)	**41**
Identifiable assets	683	**689**

[1] Includes intersegment sales eliminated on consolidation

The Specialty Cellulose Pulp segment consists of two manufacturing facilities, which produce specialty cellulose pulps. The specialty cellulose pulp mills have an annual rated capacity of 310,000 tonnes per year. The pulp produced at the two pulp mills is a high-purity cellulose utilized in a wide variety of specialized products such as pharmaceuticals, food additives, and industrial chemicals. The Temiscaming mill also produces "viscose" grade pulp, which is utilized in the production of viscose staple fibre, which in turn is used to produce rayon for the textile industry.

The specialty cellulose mills generate lignin as a by-product of the sulphite process, a portion of which is sold to third parties. The segment also includes a stand-alone resin business, which produces powder and liquid phenolic resins at two operating sites in Quebec: Temiscaming and Longueuil. The Company also operates a third facility located in Toledo, Ohio, which manufactures powder and liquid amino-resins. The chemical business periodically purchases and re-sells third party pulp mill by-product chemicals.

The following summarizes the annual operating capacity of each facility:

Specialty cellulose	**tonnes**
Specialty cellulose – Temiscaming, QC	160,000
Specialty cellulose – Tartas, France	150,000
	310,000

Chemicals	**tonnes**
Resin and related products	
– Temiscaming and Longueuil, QC; Toledo, Ohio	170,000
Lignin – Temiscaming, QC; Tartas, France	60,000

This segment is dominated by specialty pulp, which represented 82% of segment sales in fiscal 2016, as compared to 76% in the prior year. Volumes of pulp sales were higher whereas chemical volumes declined year-over-year.

	Sales ($ millions)		Shipments (000 units)		Selling prices ($ / unit)	
	2015	**2016**	2015	**2016**	2015	**2016**
Specialty pulp						
Specialty cellulose (tonnes)	268	**279**	168.8	**183.0**	1,585	**1,527**
Viscose and other grades (tonnes)	65	**101**	66.0	**89.3**	989	**1,130**
	333	**380**	234.8	**272.3**		
Chemicals						
Resin and related products (tonnes)	58	**44**	56.9	**45.9**	1,023	**959**
Lignin (tonnes)	38	**34**	88.2	**66.5**	429	**511**
Ethanol (000 litres)	1	**–**	0.7	**–**	1,090	**–**
Other chemical sales	6	**4**				
	103	**82**				
Total sales	436	**462**				
Internal pulp sales	(2)	**(5)**				
Consolidated sales	434	**457**				

Total sales for the Specialty Cellulose Pulp segment were $462 million, an increase of $26 million from the prior year. The $47 million increase in pulp sales was due to higher shipments. The $21 million decrease in chemical sales was due to lower volumes of resin and lignin products. The Specialty Cellulose Pulp segment generated 30% of Company consolidated sales as compared to 31% in the prior year. The Specialty Cellulose Pulp segment is a global business. In fiscal 2016, 77% of consolidated sales were generated outside of Canada and the U.S., compared to 69% in fiscal 2015.

Markets

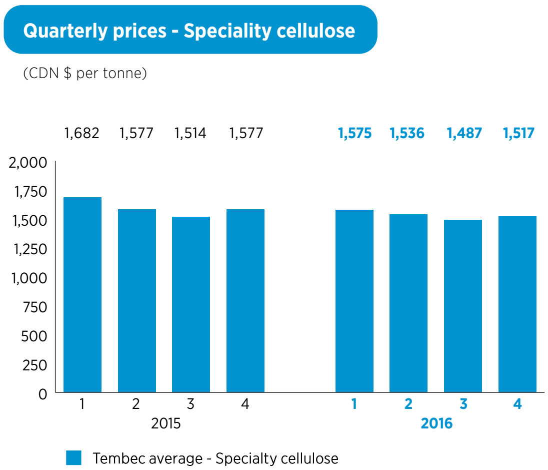
The Company markets its pulp on a world-wide basis, primarily through its own sales force. Permanent sales offices are maintained in Toronto, Canada and Dax, France. Contractual arrangements with third party representatives are also utilized.

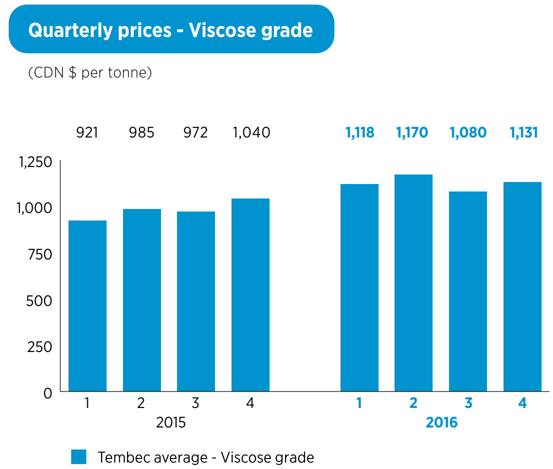
Demand for specialty grades improved and the Company sold 14,200 more tonnes in fiscal 2016, an increase of 8.4% over the prior year. While demand improved, US dollar and euro prices for specialty pulp declined by approximately 9% from the prior year. This included an unfavourable sales mix variance. Currency provided a partial offset on US dollar sales as the value of the Canadian dollar declined by 7.7% versus the US dollar. Overall, Canadian dollar equivalent pricing for specialty grades declined by $58 per tonne, or approximately 3.7% as compared to fiscal 2015.

Demand and pricing for viscose and other grades improved, with sales of 89,300 tonnes in fiscal 2016, an increase of 23,300 tonnes, or 35.3% versus the prior year. A combination of higher US dollar prices and more favourable currency rates generated an average $141 per tonne increase in selling prices for viscose and other grades.

The shipment to capacity ratio for specialty pulp was 88% in fiscal 2016 versus 76% in the prior year. The fiscal 2015 shipments had been impacted by an 18-day production stoppage at the Temiscaming specialty pulp mill due to a labour dispute with the unionized workforce. There were no unplanned stoppages in fiscal 2016, and when combined with the benefits of a new boiler and turbine, the Temiscaming pulp mill produced 20,600 more tonnes than in the prior year. As well, the Tartas mill did not incur a major maintenance outage in fiscal 2016 and produced 13,400 more tonnes than in fiscal 2015. The Tartas mill takes major maintenance outages every 18 months.

The Company has a strategy of maximizing its exposure to the specialty grade markets. The higher demand for specialty grades in fiscal 2016 led to an increase in specialty grade shipments. However, non-specialty volumes also increased as the two pulp mills benefited from increased productivity. Specialty grade volumes represented 67% of pulp shipments in fiscal 2016 compared to 72% in the prior year.





Operating results

The following summarizes adjusted EBITDA variances by major element:

				Variance – favourable (unfavourable)			
(in millions of dollars)	Price	Mill costs	Inventory NRV adjustment	Freight	Mix & volume	Other	TOTAL
Specialty pulp	2	48	2	3	(6)	1	50
Chemicals	2	(4)	–	–	–	–	(2)
	4	44	2	3	(6)	1	48

Fiscal 2016 adjusted EBITDA was $69 million compared to $21 million in the prior year, an increase of $48 million. Higher prices for viscose and other grades more than offset lower specialty grade prices and the net impact on adjusted EBITDA was an increase of $2 million. The $48 million decrease in mill costs was caused primarily by the Temiscaming mill, which recorded a positive variance of $45 million. This included a $17 million reduction in energy costs, $13 million of additional fixed cost absorption related to the previously noted production increase, a $5 million reduction in chemical costs and a $5 million reduction in maintenance material costs. The Tartas mill costs declined by $12 million as the mill did not take an annual maintenance outage in fiscal 2016. This included a favourable variance of $7 million for fixed cost absorption related to higher productivity and a favourable variance of $4 million for maintenance material. However, the stronger euro versus the Canadian dollar increased the mill's reported Canadian dollar equivalent costs by $9 million, and the mill's reported costs declined by $3 million overall. A lower price mix of specialty grades combined with a higher proportion of viscose and other grades generated an unfavourable volume and mix variance of $6 million.

The $2 million favourable chemicals price variance was due to higher lignin prices, partially offset by lower resin prices. However, lignin costs increased and the profitability of both chemical businesses declined from the prior year.

Overall, lower costs led to higher segment adjusted EBITDA and margins increased from 4.8% in 2015 to 14.9% in 2016.

The Temiscaming specialty cellulose mill purchased approximately 357,800 bone dry tonnes of wood chips in fiscal 2016, up from 278,800 in the prior year. Of this amount, approximately 64% was supplied by the Company's Forest Products segment, compared to 71% in the prior year. The remaining requirements were purchased from third parties under contracts and agreements of various durations. The pulp mill located in Southern France purchased 335,800 bone dry tonnes of wood in fiscal 2016 as compared to 322,100 bone dry tonnes in the prior year. The fibre is sourced from many private landowners.

The following summarizes operating results variances by major element:

(in millions of dollars)	2015	**2016**	Variance favourable (unfavourable)
Adjusted EBITDA	21	**69**	48
Depreciation and amortization	22	**28**	(6)
Operating earnings (loss)	(1)	**41**	42

The Specialty Cellulose Pulp segment generated operating earnings of $41 million during the most recently completed fiscal year, compared to an operating loss of $1 million in the prior year. The previously noted increase in adjusted EBITDA led to the improvement in operating results. Depreciation expense increased by $6 million as the Company depreciated the new boiler and turbine at the Temiscaming specialty pulp mill for the entire fiscal year. Fiscal 2015 results included only eight months of depreciation for the new boiler and turbine.

Paper Pulp

(in millions of dollars)	2015	2016
Sales [1]	302	**314**
Freight and other deductions	60	**64**
Cost of sales	225	**236**
SG&A	4	**5**
Adjusted EBITDA	13	**9**
Adjusted EBITDA margin on sales	4.3%	**2.9%**
Depreciation and amortization	11	**11**
Operating earnings (loss)	2	**(2)**
Identifiable assets	147	**131**

[1] Includes intersegment sales eliminated on consolidation

The Paper Pulp segment consists of two high-yield pulp manufacturing facilities. The pulp mills produce pulp with a combination of mechanical and chemical processes. The Company produces hardwood grades made from maple, aspen and birch. High-yield pulps have a lower tensile and tear strength than kraft pulps, but they offer advantages on bulk and opacity. They compete against other hardwood or "short fibre" grades, with Bleached Eucalyptus Kraft (BEK) being the most prominent.

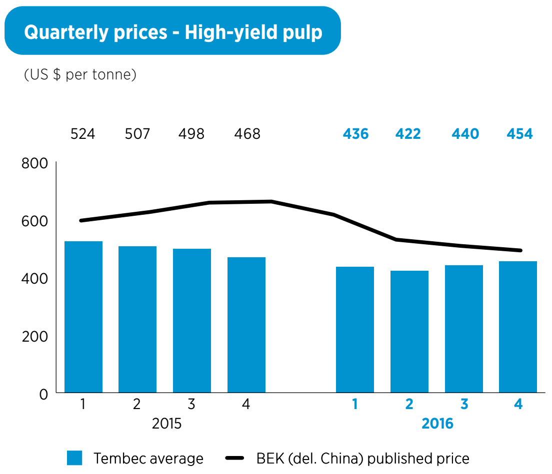
The following summarizes the annual capacity of each facility:

High-yield pulp	**tonnes**
Hardwood high-yield – Temiscaming, QC	300,000
Hardwood high-yield – Matane, QC	270,000
	570,000

This segment shipped 541,200 tonnes of high-yield pulp in fiscal 2016 compared to 492,300 tonnes in the prior year. High-yield pulp shipments included 64,700 tonnes consumed by the Company's paperboard operations, as compared to 59,600 tonnes in fiscal 2015.

	Sales ($ millions)		Shipments (000 tonnes)		Selling prices ($ / tonne)	
	2015	**2016**	2015	**2016**	2015	**2016**
Hardwood high-yield pulp	302	**314**	492.3	**541.2**	613	**580**
Internal sales	(30)	**(32)**	(59.6)	**(64.7)**		
Consolidated sales	272	**282**	432.7	**476.5**		

Total sales for the Paper Pulp segment were $314 million, an increase of $12 million from the prior year. After eliminating internal sales, the Paper Pulp segment generated 19% of Company consolidated sales, unchanged from the prior year. The Paper Pulp segment is more export oriented than the other business segments within the Company. In 2016, 99% of consolidated paper pulp sales were generated outside of Canada and the U.S., as compared to 97% in the prior year. China alone accounted for 50% of sales compared to 48% in fiscal 2015.



Markets

The Company markets its pulp on a world-wide basis, primarily through its own sales force. Sales offices are maintained in Toronto, Canada and Dax, France. Contractual arrangements with third party representatives are also utilized.

Market conditions for hardwood paper pulps were generally weaker in fiscal 2016. The benchmark price for BEK pulp decreased by US $97 per tonne. The high-yield pulp market followed a similar pattern and the Company's average price declined by US $67 per tonne. Currency provided a partial offset as the Canadian dollar was weaker versus the US dollar. As a result, Canadian dollar prices for external high-yield pulp sales declined by $37 per tonne or 5.9% from the prior year. While prices declined in fiscal 2016, demand improved and the Company sold 43,800 more tonnes to external customers, a 10.1% increase over fiscal 2015. Inventory levels of paper pulp ended the year at 25 days of supply, down from 35 days at the end of fiscal 2015.

Pulp shipments were equal to 95% of capacity as compared to 87% in the prior year. The prior year segment results had been negatively impacted by a 16-day production stoppage at the Temiscaming mill due to a labour dispute with the unionized workforce. Fiscal 2016 results include 41 days of market downtime at the Temiscaming mill due to weak demand and market conditions at the beginning of the fiscal year. Despite the relatively high market downtime, the Temiscaming mill was able to increase its production by 17,300 tonnes versus the prior year.

Operating results

The following summarizes adjusted EBITDA variances by major element:

	Variance – favourable (unfavourable)					
(in millions of dollars)	Price	Mill costs	Inventory NRV adjustments	Freight	Volume & Other	TOTAL
High-yield pulp	(18)	11	2	1	–	(4)
Other segment items	–	–	–	–	–	–
	(18)	11	2	1	–	(4)

Fiscal 2016 adjusted EBITDA was $9 million compared to $13 million in the prior year. The previously noted decrease in high-yield pulp selling prices decreased adjusted EBITDA by $18 million. Mill level costs at the two high-yield pulp mills decreased by $11 million, primarily due to lower fibre and energy costs and better fixed costs absorption due to an increase in productivity.

The two pulp mills purchased approximately 546,000 bone dry tonnes of wood chips in fiscal 2016, as compared to 527,200 tonnes in the prior year. Of this amount, approximately 39% was supplied by the Forest Products segment, unchanged from the prior year. The remaining requirements were purchased from third parties under contracts and agreements of various durations.

Overall, lower high-yield pulp prices, partially offset by lower costs led to the decline in profitability with an adjusted EBITDA margin of 2.9% in fiscal 2016 compared to 4.3% in the prior year.

The following summarizes operating results variances by major element:

(in millions of dollars)	2015	**2016**	Variance favourable (unfavourable)
Adjusted EBITDA	13	**9**	(4)
Depreciation and amortization	11	**11**	–
Operating earnings (loss)	2	**(2)**	(4)

The Paper Pulp segment generated an operating loss of $2 million during the most recently completed fiscal year, compared to operating earnings of $2 million in the prior year. The previously noted decrease in adjusted EBITDA led to the decline in operating results.

Paper

(in millions of dollars)	2015	2016
Sales	337	392
Freight and other deductions	42	44
Cost of sales	247	267
SG&A	10	9
Adjusted EBITDA	38	72
Adjusted EBITDA margin on sales	11.3%	18.4%
Depreciation and amortization	4	6
Operating earnings	34	66
Identifiable assets	163	162

The Paper segment currently includes two paper manufacturing facilities with a total of three paper machines. The mill located in Kapuskasing, Ontario, produces newsprint on two machines. The facility located in Temiscaming, Quebec, produces multi-ply coated bleached board on one machine. The board mill is partially integrated with a high-yield pulp mill. The total capacity of the Paper segment is 400,000 tonnes.

The following summarizes the products and capacity of each facility:

Coated bleached board	**tonnes**
Temiscaming, QC	180,000

Newsprint	**tonnes**
Kapuskasing, ON	220,000

Coated bleached board shipments represented 48% of Paper segment shipments in fiscal 2016, as compared to 45% in the prior year. Newsprint shipments represented 52% of Paper segment shipments in fiscal 2016, as compared to 55% in the prior year. As a percentage of total segment sales, coated bleached board represented 70% of sales compared to 66% in the prior year. Newsprint represented 30% of total segment sales compared to 34% in the prior year.

Sales for the Paper segment totalled $392 million, as compared to $337 million in the prior year. The segment generated 26% of Company consolidated sales, as compared to 24% in fiscal 2015. The focus of the paper business is North America, which accounted for 93% of consolidated sales in 2016, as compared to 91% in fiscal 2015. The U.S. alone accounted for 73% of sales in fiscal 2016, as compared to 74% in the prior year.

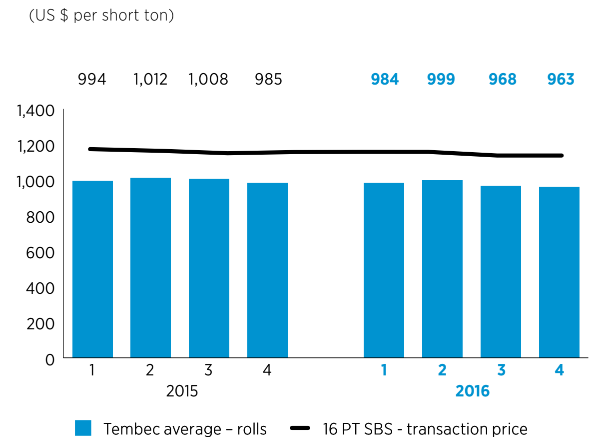
	Sales ($ millions)		Shipments (000 tonnes)		Selling prices ($ / tonne)	
	2015	2016	2015	2016	2015	2016
Coated bleached board (rolls and sheets)	221	273	153.8	180.7	1,434	1,508
Newsprint	116	119	189.8	198.4	612	602
Consolidated sales	337	392	343.6	379.1		

Markets

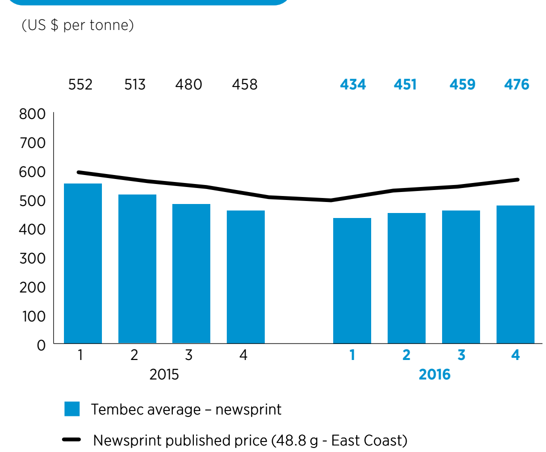
Market conditions for coated bleached board remained relatively stable. The benchmark reference price for coated bleached board rolls (16 point) averaged US $1,170 per short ton in fiscal 2016, a US $15 per short ton decrease over the prior year. Currency was a positive factor as the Canadian dollar averaged US $0.754, a 7.7% decrease from US $0.817. Overall, average selling prices for coated bleached board rolls and sheets increased by $74 per tonne. The shipment to capacity ratio for coated bleached board was 100% in fiscal 2016 compared to 85% in the prior year. Increased demand in fiscal 2016 led to shipments that exceeded production and reduced finished goods inventories. The coated bleached board inventory level at year-end was equal to 59 days of supply compared to 65 days at the end of the prior year. Fiscal 2015 shipments had been impacted by a 13-day production stoppage at the coated bleached board mill in Temiscaming due to a labour dispute with the unionized workforce. The mill produced 13,400 more tonnes in fiscal 2016.

The newsprint market remained relatively weak. The benchmark newsprint price (48.8 gram – East Coast) averaged US $542 per tonne in fiscal 2016, a decrease of US $20 per tonne from the prior year. The weaker Canadian dollar partially offset this decrease and average newsprint prices declined by $10 per tonne. The shipment to capacity ratio for newsprint was 90% as compared to 79% in the prior year. The newsprint mill produced 3,300 more tonnes in fiscal 2016 and also reduced its inventory of finished goods. Inventories of newsprint were at approximately 15 days of supply at year-end, compared to 17 days at the end of the prior year.

Quarterly prices - Coated bleached board



Quarterly prices - Newsprint



Operating results

The following summarizes adjusted EBITDA variances by major element:

	Variance – favourable (unfavourable)					
(in millions of dollars)	Price	Mill costs	Freight	Mix & volume	Other	TOTAL
Coated bleached board	14	5	–	5	(1)	23
Newsprint	(2)	10	2	–	1	11
	12	15	2	5	–	34

Fiscal 2016 adjusted EBITDA was $72 million compared to $38 million in the prior year. The previously noted improvement in coated bleached board prices increased adjusted EBITDA by $14 million. The coated bleached board mill level costs decreased by $5 million, primarily due to improved fixed cost absorption associated with the higher productivity. The higher sales volume added a further $5 million to adjusted EBITDA. The previously noted decline in Canadian dollar newsprint prices reduced adjusted EBITDA by $2 million. Mill level manufacturing costs declined by $10 million at the newsprint mill, including $6 million for energy costs. Lower freight and other costs increased adjusted EBITDA by a further $3 million.

Overall, higher prices and lower costs increased segment adjusted EBITDA margins from 11.3% to 18.4%.

The coated bleached board mill utilizes a combination of chemical kraft pulp and high-yield pulp to produce a three-ply sheet. During fiscal 2016, the mill utilized 64,700 tonnes of high-yield pulp supplied by the Temiscaming high-yield pulp mill versus 59,600 tonnes supplied in fiscal 2015. The balance of pulp requirements was purchased from third parties.

The newsprint mill utilizes virgin fibre, primarily in the form of wood chips. During fiscal 2016, the operations consumed 221,800 bone dry tonnes of virgin fibre, of which 100% was internally sourced. In the prior year, 199,400 bone dry tonnes of virgin fibre were consumed, with 100% being sourced internally.

The following summarizes operating results variances by major element:

(in millions of dollars)	2015	**2016**	Variance favourable (unfavourable)
Adjusted EBITDA	38	**72**	34
Depreciation and amortization	4	**6**	(2)
Operating earnings	34	**66**	32

The Paper segment generated operating earnings of $66 million compared to operating earnings of $34 million in the prior year. The previously noted increase in adjusted EBITDA led to the higher operating earnings.

Corporate

(in millions of dollars)	2015	2016
General and administrative expenses	17	**19**
Share-based compensation	(3)	**(1)**
Depreciation and amortization	1	**1**
Other items:		
Custodial – idled facilities	2	**3**
Settlement gain - sale of pulp mills	–	**(5)**
Settlement gain - pension plan	–	**(1)**
Gain on sale of land / building	(1)	**(1)**
Settlement gain - non-recourse debt obligation	(9)	**–**
Impairment loss - Temlam loan receivable	3	**–**
Past service cost - defined benefit pension plan	1	**–**
Operating loss	11	**15**

The $2 million increase in corporate general and administration expenses relates to increased short-term incentive plan (STIP) accruals for corporate personnel. The fiscal 2016 financial results exceeded STIP target levels. In fiscal 2015, the financial results were less than STIP target levels.

The Company recorded a $1 million credit for share-based compensation in fiscal 2016, as compared to a $3 million credit in the prior year. 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 plans administration and remediation activities. These "legacy" items totalled $3 million in fiscal 2016 as compared to $2 million in fiscal 2015.

Fiscal 2016 includes a gain of $5 million related to the final settlement of a net working capital adjustment. In May 2010, the Company sold two kraft pulp mills located in Southern France. The terms of the sale provided for a post-closing purchase price adjustment based on the actual working capital balances at closing. The Company and the buyer could not come to an agreement on the amount to be paid and the matter had been in dispute since that time. The Company received a payment of $5 million in the June 2016 quarter to effectively settle the dispute. The Company recorded a settlement gain of $1 million related to a legacy defined benefit pension plan. The Company recorded a gain of $1 million related to the sale of the idled hardwood flooring plant assets in Huntsville, Ontario. The gain was equal to the consideration received.

In fiscal 2015, the Company recorded a gain of $9 million related to the settlement of a non-recourse debt obligation. The Company also completed a land sale for $2 million and recorded a gain of $1 million. The prior year results also included a $3 million charge relating to the impairment of a loan receivable from Temlam Inc. The latter owned an idled LVL manufacturing facility. The Company had a secured interest in the facility. The carrying value of the loan was reduced by $3 million to reflect the net proceeds of sale ultimately received by the Company in January 2015. The Company negotiated a new collective agreement with the Temiscaming, Quebec, unionized workforce in fiscal 2015. The new agreement included pension improvements that generated a charge of $1 million.

Non-operating items

Interest, foreign exchange and other

(in millions of dollars)	2015	2016
Interest on debt	52	**61**
Amortization of financing costs	3	**5**
Interest income	–	**(1)**
Foreign exchange items	(8)	**1**
Employee future benefits	4	**5**
Bank charges and other	3	**4**
	54	**75**

Fiscal 2016 and fiscal 2015 interest expense relates primarily to interest on the US $375 million – 9% senior secured notes maturing in December 2019. The $9 million increase in interest expense is due primarily to a US $62 million term loan facility that was put in place in November 2015. Financing costs are amortized over the remaining term of each respective credit facility. Foreign exchange items are primarily caused by gains or losses on the translation of US dollar net monetary assets. In fiscal 2015, the relative value of the Canadian dollar versus the US dollar decreased from US $0.896 to US $0.751, generating a credit of $8 million. In fiscal 2016, the relative value of the Canadian dollar increased from US $0.751 to US $0.759, generating a charge of $1 million. The charge for employee future benefits relates to interest accretion on net unfunded obligations.

Loss on refinancing of long-term debt

On October 1, 2014, the Company completed a private debt offering of US $375 million – 9% senior secured notes due in December 2019. A portion of the proceeds from the offering was utilized to redeem all of the Company's US $305 million – 11.25% senior secured notes due in December 2018, as well as an early prepayment penalty of $27 million (US $24 million). In addition, the Company absorbed a $10 million charge related to the elimination of previously deferred financing costs.

Translation of foreign debt

During fiscal 2016, the Company recorded a gain of $6 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar increased from US $0.751 to US $0.759.

During fiscal 2015, the Company recorded a loss of $81 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.896 to US $0.751.

Income taxes

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

(in millions of dollars)	2015	2016
Earnings (loss) before income taxes	(141)	**30**
Anticipated income tax expense (recovery)	(37)	**8**
Difference in statutory income tax rates	2	**3**
Unrecognized tax asset	30	**1**
Non-deductible (non-taxable) portion of foreign exchange loss (gain) on long-term debt	11	**(1)**
Permanent differences and other tax adjustments	3	**(1)**
Income tax expense	9	**10**

During fiscal 2016, the Company recorded an income tax expense of $10 million on earnings before income taxes of $30 million. The income tax expense reflected a $2 million unfavourable variance versus an anticipated income tax expense of $8 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 $3 million. This was caused by the higher corporate tax rate applicable to the Company's French operations. The income tax expense increased by $1 million as the result of losses for which no deferred tax asset was recognized. The Company has a significant balance of unrecognized tax assets relating to its Canadian operations since it has not been determined that the future realization of these assets is probable. The non-taxable portion of the foreign exchange gain on translation of debt decreased the income tax expense by $1 million. Permanent differences and other tax adjustments decreased the income tax expense by $1 million.

During fiscal 2015, the Company recorded an income tax expense of $9 million on a loss before income taxes of $141 million. The income tax expense reflected a $46 million unfavourable variance versus an anticipated income tax recovery of $37 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 $2 million. This was caused by the higher corporate tax rate applicable to the Company's French operations. The income tax expense increased by $30 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 $11 million. Permanent differences and other tax adjustments increased the income tax expense by $3 million.

Net earnings (loss)

The Company generated net earnings of $20 million or $0.20 per share for the year ended September 24, 2016, compared to a net loss of $150 million or $1.50 per share for the year ended September 26, 2015.

Comprehensive loss

The following table summarizes the impact of items affecting the reported total comprehensive loss during the last two fiscal years:

(in millions of dollars)	2015	**2016**
Net earnings (loss)	(150)	**20**
Employee future benefit loss	(5)	**(31)**
Foreign currency translation gain (loss) on foreign operations	7	**(1)**
Total comprehensive loss	(148)	**(12)**

During fiscal 2016, the Company recognized a loss of $31 million relating to the increase of the estimated net obligation for employee future benefits. The return on plan assets was more than the expected return, reducing the net obligation by $57 million. The average discount rate applied to estimate the present value of future obligations decreased from 4.04% to 3.24%, thereby increasing the net obligation by $95 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. The recognition of previously unrecognized plan assets reduced the net obligation by $1 million. Changes to demographic assumptions decreased the net obligation by $6 million.

During fiscal 2015, the Company recognized a loss of $5 million relating to the increase of the estimated net obligation for employee future benefits. The average discount rate applied to estimate the present value of future obligations increased from 4.03% to 4.04%, thereby reducing the net obligation by $1 million. The return on plan assets exceeded the expected return, decreasing the net obligation by $5 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. This increased the net obligation by $3 million. Changes to demographic assumptions and plan experience increased the net obligation by $8 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 fiscal 2016, the currency translation of the French operations generated a loss of $2 million. The currency translation of the U.S. operations generated a gain of $1 million. During fiscal 2015, the currency translation of the French operations generated a gain of $10 million. The currency translation of the U.S. operations generated a loss of $3 million.

Subsequent event

On October 31, 2016, the Company completed the previously announced sale of the Senneterre, Quebec, sawmill and related forestry assets. The sale also included certain working capital items. The Company received proceeds of $9 million on closing, subject to normal post-closing working capital adjustments. The transaction will not give rise to a gain or a loss on disposition.

During the 12-month period ended September 2016, the sawmill had sold 61 million board feet of stud lumber, generating sales of $24 million. Chip and by-product sales added a further $7 million. The sawmill generated negative adjusted EBITDA of $5 million in fiscal 2016.

Quarterly financial information

(in millions of dollars, except per share amounts)				2015				2016
	Dec. 14	March 15	June 15	Sept. 15	Dec. 15	March 16	June 16	Sept. 16
Sales	332	348	365	373	354	380	376	389
Adjusted EBITDA	20	12	2	36	29	36	26	57
Depreciation and amortization	9	10	12	12	12	13	13	15
Other items expense (credit)	3	(8)	1	–	1	–	(5)	–
Operating earnings (loss)	8	10	(11)	24	16	23	18	42
Net earnings (loss)	(62)	(40)	(16)	(32)	(28)	27	9	12
Basic and fully diluted net earnings (loss) per share ($)	(0.62)	(0.40)	(0.16)	(0.32)	(0.28)	0.27	0.09	0.12
Comprehensive earnings (loss)	(81)	(43)	5	(29)	(16)	(10)	(8)	22

Fourth quarter analysis

The Company reported net earnings of $12 million or $0.12 per share in the fourth quarter ended September 24, 2016, compared to a net loss of $32 million or $0.32 per share in the same quarter of fiscal 2015. The weighted average number of common shares outstanding was 100 million, unchanged from the prior year quarter.

Sales increased by $16 million from the same quarter a year ago. Currency was not a significant factor as the Canadian dollar averaged US $0.767, similar to US $0.765 in the year ago quarter. Forest Products segment sales increased by $6 million as a result of higher lumber prices and increased shipments of logs. Specialty Cellulose Pulp segment sales increased by $1 million due to higher shipments, partially offset by lower prices. Paper Pulp segment sales increased by $3 million due to higher shipments, partially offset by lower prices. Paper segment sales increased by $6 million due to higher shipments, partially offset by lower prices.

Adjusted EBITDA increased by $21 million from the prior year quarter. Forest Products segment adjusted EBITDA increased by $8 million due to higher prices and lower costs. Specialty Cellulose Pulp segment adjusted EBITDA increased by $8 million due to lower costs, partially offset by lower prices. Paper Pulp segment adjusted EBITDA increased by $1 million due to lower costs, partially offset by lower prices. Paper segment adjusted EBITDA increased by $6 million due to lower costs, partially offset by lower prices.

The Company generated operating earnings of $42 million compared to operating earnings of $24 million in the same quarter a year ago. The previously noted improvement in adjusted EBITDA led to the improvement in operating results.

The fourth quarter 2016 interim MD&A issued on November 17, 2016, provides a more extensive analysis of items having impacted the Company's fourth quarter financial results.

Summary of quarterly results

On a quarterly basis, sales and margins were negatively impacted by relatively low lumber, paper pulp and newsprint US dollar prices. The movement in currency rates was beneficial to Canadian operations as the Canadian dollar declined from US $0.896 at the end of September 2014 to US $0.759 at the end of September 2016, averaging US $0.786 over the last eight quarters.

The Forest Products segment generated adjusted EBITDA of $28 million during the last eight quarters. This represents an average margin of 3.2% on sales of $871 million. The Company's SPF lumber shipment to capacity ratio averaged 84%. The U.S. housing market improved modestly, but lumber prices declined. The previously noted weaker Canadian dollar partially offset the decline in US dollar prices and selling prices and margins for the Company remained relatively unchanged year-over-year.

The Specialty Cellulose Pulp segment generated adjusted EBITDA of $90 million during the last eight quarters. This represents an average margin of 10.0% on sales of $898 million. Selling prices for specialty pulp significantly weakened during the last eight quarters. However, average margins increased from 4.8% in fiscal 2015 to 14.9% in fiscal 2016 due to lower manufacturing costs.

The Paper Pulp segment generated $22 million of adjusted EBITDA during the last eight quarters. This represents an average margin of 3.6% on sales of $616 million. The market for paper pulp has been weak over the last two fiscal years. New hardwood capacity expansions in South America and Indonesia have led to low US dollar selling prices.

The Paper segment generated adjusted EBITDA of $110 million over the last eight quarters. This represents an average margin of 15.1% on sales of $729 million. Relatively stable US dollar prices for coated bleached board and newsprint combined with a weaker Canadian dollar have led to improved segment results.

Corporate general and administrative expenses of the Company have averaged approximately $4 million to $5 million per quarter over the last two fiscal years and there were no significant changes in the composition of those expenses.

Overall, the Company generated adjusted EBITDA of $218 million in the last eight quarters. This represents an average margin of approximately 7.5% on consolidated sales of $2.9 billion. Significant cost reduction and productivity gains in fiscal 2016 generated consolidated margins of 9.9% versus 4.9% in fiscal 2015.

Corporate other items increased the Company's operating earnings by $8 million during the last eight quarters. While there were several offsetting favourable and unfavourable items, the most significant favourable item was a $9 million gain on the settlement of a non-recourse debt obligation.

The Company recorded a loss of $75 million on the translation of its foreign-denominated debt over the last two fiscal years. However, the impact of the quarterly US debt translation gains and losses added considerable volatility to the financial results, with the impact ranging from a gain of $27 million in the March 2016 quarter to a loss of $38 million in the September 2015 quarter.

During the last two fiscal years, the Company has recorded an income tax expense of $19 million. The expense relates primarily to its French operations as the Canadian operations have significant amounts of unrecognized tax assets.

Financial position and liquidity

Free cash flow

(in millions of dollars)	2015	2016
Cash flow from operations before working capital changes	53	**126**
Less:		
Additions to property, plant and equipment	57	**44**
Interest on debt	52	**61**
Free cash flow (negative)	(56)	**21**

Cash flow from operations before working capital changes in fiscal 2016 was $126 million, compared to $53 million in the prior year. The increase in cash flow from operations was due to a $78 million increase in adjusted EBITDA. After allowing for capital expenditures of $44 million and interest on debt of $61 million, free cash flow in fiscal 2016 was $21 million compared to negative $56 million in the prior year.

In fiscal 2016, non-cash working capital items generated $21 million. The decrease in working capital was caused primarily by a $12 million decrease in inventories. As a result, cash flow from operating activities increased from $20 million in fiscal 2015 to $147 million in fiscal 2016.

Capital spending

(in millions of dollars)	2015	2016
Forest Products	13	**10**
Specialty Cellulose Pulp – Cogen project		
Construction	19	**–**
Start-up	3	**–**
Specialty Cellulose Pulp – Other	13	**24**
Paper Pulp	5	**5**
Paper	4	**5**
Net capital expenditures	57	**44**
As a % of consolidated sales	4.0%	**2.9%**
As a % of depreciation	133%	**83%**

During fiscal 2016, capital expenditures totalled $44 million, as compared to $57 million in the prior year. The lower level of capital expenditures relates to one relatively large capital project. In March 2012, the Company announced a major capital investment to upgrade its specialty cellulose mill in Temiscaming, Quebec. The project involved the replacement of three low-pressure boilers with a single new high-pressure boiler designed to burn waste sulphite liquor generated by the specialty cellulose manufacturing process. The project also included the installation of a new 50-megawatt electrical turbine. During fiscal 2015, $19 million was spent on the project construction costs. The Company also incurred $3 million of start-up costs related to the project in fiscal 2015. Capital spending ceased in the June 2015 quarter when the project was completed.

The Company estimates that annual capital expenditures of $35 million to $40 million are required to adequately maintain its facilities.

Financing activities — Liquidity

The Company has set an objective of maintaining a minimum liquidity of $135 million to $150 million. As at September 24, 2016, the Company had total cash, including restricted cash, of $46 million plus unused operating lines of $102 million, for total liquidity of $148 million. At September 26, 2015, the Company had total cash, including restricted cash, of $23 million and unused operating lines of $33 million, for total liquidity of $56 million. The increase in liquidity was driven by significantly higher adjusted EBITDA in fiscal 2016 as well as lower capital expenditures.

The following table summarizes the unused operating lines at the end of the last two fiscal years:

(in millions of dollars)	2015	2016
Borrowing base	210	190
Less: fixed availability reserves	(15)	(31)
Less: variable availability reserves	(2)	–
Net availability	193	159
Outstanding letters of credit	(46)	(45)
Amount drawn	(114)	(12)
Unused amount	33	102

At the end of the September 2015 period, the Company had a $175 million ABL facility expiring in March 2018. The ABL facility was refinanced on November 18, 2015. The new 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. Subsequent to the end of fiscal 2016, 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 new 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. The fixed reserves associated with the ABL revolver tranche were increased to approximately $31 million primarily as a result of the FILO loan.

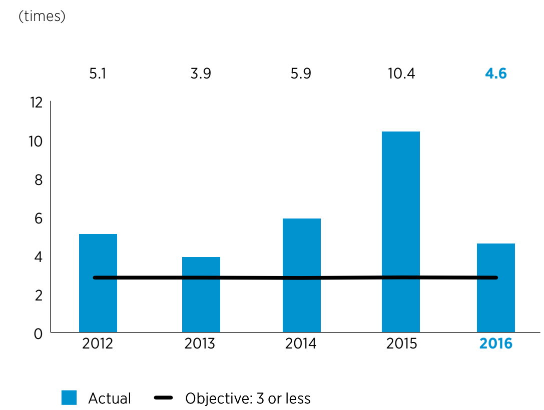
The ABL credit agreement contains an annual mandatory prepayment clause related to the FILO loan. The amount of the annual mandatory prepayment is based on the Company's profitability in the prior fiscal year. The prepayment can only be made if ABL revolver availability is at or above $100 million after the prepayment is made. Based on the Company's fiscal 2016 results, the amount of the prepayment has been calculated to be $16 million. The Company anticipates making this payment in late November 2016. There is no prepayment premium or penalty applicable to the mandatory prepayment and the entire amount is included in the current portion of long-term debt. The impact on liquidity will be minimal as the fixed availability reserve on the ABL revolver borrowing base will decline from $31 million to $15 million when the prepayment is made. An amount of $10 million was drawn on the ABL revolver as at September 24, 2016.

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. As at the end of September 2016, there were $12 million of outstanding letters of credit issued on this facility. The remaining $33 million of letters of credit have been issued on the ABL revolver facility.

The French operations are supported by "receivable factoring" agreements. As such, the borrowing base fluctuates periodically, depending on shipments and cash receipts. As at the end of September 2016, an amount of $2 million was drawn on these facilities.

Net debt to last twelve months adjusted EBITDA



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

(in millions of dollars)	2015	2016
US $375 million – 9% senior secured notes - December 2019	499	**494**
US $62 million FILO loan - LIBOR +7.25% - September 2018	–	**82**
Temiscaming project term loan - 5.5% - April 2028	75	**75**
Temiscaming project term loan - 5.5% - March 2020	18	**18**
Temiscaming project term loan - 6.35% tranche - July 2022	19	**18**
Temiscaming project term loan - 6.86% tranche - October 2022	19	**18**
French operations	7	**10**
Other debt	1	**1**
Total long-term debt	638	**716**
Less unamortized financing costs	14	**15**
	624	**701**
Current portion included in above	11	**22**

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.

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 September 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 of $670,000 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.

The debt of the French operations relates to the Company's specialty cellulose pulp mill. The increase in debt was due to new borrowings in fiscal 2016. The funds were utilized to assist with capital expenditures at the pulp mill.

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. During the September 2016 quarter, S&P revised the outlook on its rating from "negative" to "stable".

The Company has set certain objectives relating to its level of indebtedness. The following table summarizes the debt ratios at the end of the last two fiscal years versus the objectives:

(in millions of dollars)	2015	2016	Objective
Net debt / LTM (last twelve months) adjusted EBITDA (times)	10.4	4.6	3
Adjusted EBITDA / interest on indebtedness (times)	1.3	2.4	3
Net debt / total capitalization (%)	76%	74%	40%

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 Company recognizes that the investment in the Temiscaming Cogen project led to a significant increase in its debt levels. Now that the project is complete and operational, the focus will be to reduce leverage.

The improvement on debt ratios in fiscal 2016 was due to the significant increase in adjusted EBITDA as well as a $47 million reduction in net debt.

Common shares

(in millions)	2015	2016
Shares outstanding - opening	100	100
Shares outstanding - ending	100	100

There were no shares issued in fiscal 2015 and fiscal 2016.

In connection with the $75 million second ranking term loan facility, the Company has granted the lender an option to acquire 3 million common shares of the Corporation at a price of $7 per share. The option expires on August 30, 2017. In connection with the $18 million second ranking term loan facility, the Company has granted the lender an option to acquire 712,000 common shares of the Corporation at a price of $3.783 per share. The option expires on December 11, 2018.

Financial instruments and contractual obligations

Financial assets and liabilities

As at September 24, 2016 (in millions of dollars)	Carrying value	Fair value
Financial assets		
Cash and cash equivalents	44	44
Restricted cash	2	2
Trade and other receivables	153	153
Loans receivable	1	1
Financial liabilities		
Operating bank loans	7	12
Trade, other payables and accrued charges	193	193
Interest payable	13	13
Long-term debt (including current portion)	701	594

The carrying values for cash and cash equivalents, restricted cash, trade and other receivables, loans receivable, trade, other payables and accrued charges, and interest payable approximate their fair values due to the near-term maturity of these instruments.

The fair value of the operating bank loans exceeds their carrying value due to unamortized financing costs of $5 million, which were netted against the outstanding amount of operating bank loans. The fair value of the long-term debt was reduced by $122 million as the Company's US $375 million senior notes were trading below par at year-end. The balance of the difference relates to unamortized financing costs of $15 million, which were netted against the outstanding amount of long-term debt.

Financial risks

Credit risk

Credit risk arises from the possibility that entities to which the Company sells products may experience financial difficulty and be unable to fulfill their contractual obligations. The Company does not have a significant exposure to any individual customer or counterparty. The Company reviews a new customer's credit history before extending credit and conducts regular reviews of its existing customers' credit performance. All credit limits are subject to evaluation and revision at any time based on changes in levels of creditworthiness and must be reviewed at least once per year. Sales orders cannot be processed unless a credit limit has been properly approved. The Company may require payment guarantees, such as letters of credit, or obtain credit insurance coverage. Bad debt expense has not been significant in the past. The allowance for doubtful accounts at the end of September 2016 was negligible, unchanged from the end of the prior year.

Liquidity risk

Liquidity risk arises from the possibility that the Company will not be able to meet its financial obligations as they fall due. The Company has an objective of maintaining liquidity equal to 12 months of maintenance capital expenditures, interest and principal repayments, seasonal working capital requirements and general corporate purposes, which would require approximately $135 million to $150 million of liquidity. As noted previously, the Company had total cash of $46 million, including restricted cash, plus unused operating lines of $102 million, for total liquidity of $148 million as at September 24, 2016. At the end of the prior fiscal year, the Company had total cash, including restricted cash, of $23 million and unused operating lines of $33 million, for total liquidity of $56 million. The increase in liquidity was driven by significantly higher adjusted EBITDA in fiscal 2016 as well as lower capital expenditures.

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.

Foreign currency risk

This item is discussed in detail in a subsequent section of the MD&A, "Significant Risks and Uncertainties".

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. This will have little impact on the Company's financial results since the majority of the Company's debts are at fixed interest rates.

Commodity price and operational risk

These items are discussed in detail in a subsequent section of the MD&A, "Significant Risks and Uncertainties".

Contractual obligations

The following table shows the Company's contractual obligations as at September 24, 2016. The Company has long-term debt with contractual maturities and applicable interest. Pension obligations past service costs include estimated solvency and going concern amortization payments.

(in millions of dollars)	Total	Within 1 year	2 – 3 years	4 – 5 years	After 5 years
Long-term debt	716	21	85	530	80
Interest on long-term debt	196	59	106	20	11
Pension obligations – past service costs	16	2	4	2	8
	928	82	195	552	99

Other contractual obligations not included in the table above are:

- Operating lease obligations totalling $7 million, related primarily to property and equipment rentals entered into the normal course of business.
- Outstanding payables and accruals of $7 million related to capital expenditures.
- Purchase obligations related to ongoing normal commercial commitments to purchase timber, fibre, energy, chemicals and other operating inputs. Many of the obligations are subject to "force majeure" clauses and may vary significantly from contracted amounts depending on the Company's requirements.

2015 vs. 2014

Financial summary

(in millions of dollars, unless otherwise noted)	2014	2015
Sales	1,491	1,418
Adjusted EBITDA	90	70
Depreciation and amortization	37	43
Other items	(35)	(4)
Operating earnings	88	31
Net earnings (loss)	9	(150)
Basic and diluted net earnings (loss) in dollars per share	0.09	(1.50)
Total assets (at year-end)	1,155	1,176
Total long-term debt (at year-end) [1]	472	624
Total long-term liabilities (at year-end)	603	775

[1] Includes current portion

In this section, current year refers to fiscal 2015 and prior year refers to fiscal 2014.

Sales decreased by $73 million from the prior year. Currency was a positive factor as the Canadian dollar averaged US $0.817, an 11.6% decrease from US $0.924 in the prior year. Forest Products segment sales increased by $6 million as a result of higher prices. Specialty Cellulose Pulp segment sales decreased by $67 million due to lower shipments and prices. Paper Pulp segment sales declined by $8 million due to lower shipments. Paper segment sales declined by $2 million due to lower shipments, largely offset by higher prices.

Adjusted EBITDA

(in millions of dollars)	2014	2015	Total variance	Price variance	Cost & volume variance
Forest Products	17	12	(5)	8	(13)
Specialty Cellulose Pulp	67	21	(46)	(20)	(26)
Paper Pulp	6	13	7	3	4
Paper	21	38	17	26	(9)
Corporate	(21)	(14)	7	–	7
	90	70	(20)	17	(37)

Adjusted EBITDA decreased by $20 million from the prior year. Forest Products segment adjusted EBITDA decreased by $5 million due to higher costs, partially offset by higher prices. Specialty Cellulose Pulp segment adjusted EBITDA declined by $46 million due to higher costs and lower prices. Paper Pulp segment adjusted EBITDA increased by $7 million due to higher prices and lower costs. Paper segment adjusted EBITDA increased by $17 million due to higher prices, partially offset by higher costs. The decline in Corporate segment costs was due primarily to a $6 million reduction in share-based compensation.

Operating earnings (loss)

(in millions of dollars)	2014	2015	Total variance	Adjusted EBITDA variance	Depreciation variance	Other items variance
Forest Products	10	7	(3)	(5)	2	–
Specialty Cellulose Pulp	52	(1)	(53)	(46)	(7)	–
Paper Pulp	(5)	2	7	7	–	–
Paper	18	34	16	17	(1)	–
Corporate	13	(11)	(24)	7	–	(31)
	88	31	(57)	(20)	(6)	(31)

The Company generated operating earnings of $31 million compared to operating earnings of $88 million in the prior year. In addition to the previously noted decline in adjusted EBITDA, results were negatively impacted by a $6 million increase in depreciation expense and an unfavourable $31 million variance in other items.

The increase in depreciation expense was related to the new boiler and turbine that was put into service at the Temiscaming specialty cellulose mill.

The negative $24 million variance in Corporate costs was due to several items that occurred in each of fiscal 2015 and fiscal 2014. The following summarizes the various items:

(in millions of dollars)	2014	2015
General and administrative expenses	18	17
Share-based compensation	3	(3)
Depreciation and amortization	1	1
Other items:		
Custodial costs - idled facilities	5	2
Gain on sale of land	(49)	(1)
Settlement gain - non-recourse debt obligation	–	(9)
Impairment loss - Temlam loan receivable	–	3
Past service cost - defined benefit pension plan	–	1
Gain on sale of Chetwynd pulp mill	(1)	–
Loss on termination of BC defined benefit pension plan	7	–
Reorganization - severance costs	3	–
Operating loss (earnings)	(13)	11

The Company recorded a $3 million credit for share-based compensation in fiscal 2015, as compared to a $3 million charge in fiscal 2014.

The Corporate segment's "other items" include expenses relating to several permanently idled facilities. The costs relate to custodial, site security, legal, pension administration and remediation activities. These "legacy" items totalled $2 million in the most recent year compared to a $5 million expense a year ago.

In fiscal 2015, the Company completed a land sale for proceeds of $2 million and recorded a gain of $1 million. In the prior year, the Company completed six land sale transactions for total consideration of $60 million and recorded a gain of $49 million. The Company recorded a gain of $9 million related to the settlement of a non-recourse debt obligation. The debt was secured by a charge against the Kirkland Lake, Ontario, finger-joint plant, which has been idle since 2008. Fiscal 2015 results also include a $3 million charge relating to the impairment of a loan receivable from Temlam Inc. The latter owned an idled laminated veneer lumber (LVL) manufacturing facility located in Amos, Quebec. The Company had a 50% secured interest in the facility. The Company reduced the carrying value of its loan receivable by $3 million to reflect the total net proceeds of $4 million received when Temlam Inc. sold the facility in January 2015. The Company negotiated a new collective agreement with the Temiscaming, Quebec, unionized workforce. The agreement included a provision to increase pension payments to retirees, which increased the estimated present value of pension obligations by $1 million with a related charge to operating earnings.

In fiscal 2014, the Company completed the sale of the Chetwynd, BC, high-yield pulp mill for a nominal amount. The sale generated a $1 million gain as the buyer assumed certain liabilities associated with the facility. The Company terminated its BC defined benefit pension plan and recorded a charge of $7 million. The Company entered into an agreement with an insurance company to settle a $55 million pension obligation for an amount of $62 million, which was equivalent to the amount of plan assets held in trust at the time of the settlement. The Company also reorganized certain functions and roles and recorded a charge of $3 million relating to severance and salary continuance costs associated with personnel reductions.

Interest, foreign exchange and other

(in millions of dollars)	2014	2015
Interest on debt	46	52
Amortization of financing costs	3	3
Capitalized interest	(18)	–
Foreign exchange items	(5)	(8)
Employee future benefits	4	4
Bank charges and other	3	3
	33	54

Fiscal 2015 interest expense related primarily to interest on the US $375 million – 9% senior secured notes maturing in December 2019. Fiscal 2014 interest expense related primarily to interest on the US $305 million – 11.25% senior secured notes. The $6 million increase in interest expense was due primarily to new project debt incurred to fund the Temiscaming, QC, specialty cellulose cogeneration project, which totalled $131 million at the end of September 2015. Financing costs are amortized over the remaining term of each respective credit facility. Capitalized interest was related to the Temiscaming, QC, specialty cellulose cogeneration project. Interest capitalization ceased at the end of September 2014. Foreign exchange items were primarily caused by gains or losses on the translation of US dollar net monetary assets. The charge for employee future benefits related to interest accretion on net unfunded obligations.

During fiscal 2015, the Company recorded a loss of $81 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.896 to US $0.751. During fiscal 2014, the Company recorded a loss of $26 million on the translation of its US dollar denominated debt as the relative value of the Canadian dollar decreased from US $0.971 to US $0.896.

During fiscal 2015, the Company recorded an income tax expense of $9 million on a loss before income taxes of $141 million. The income tax expense reflected a $46 million unfavourable variance versus an anticipated income tax recovery of $37 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 $2 million. This was caused by the higher corporate tax rate applicable to the Company's French operations. The income tax expense was increased by $30 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 $11 million. Permanent differences and other tax adjustments increased the income tax expense by $3 million.

During fiscal 2014, the Company recorded an income tax expense of $20 million on earnings before income taxes of $29 million. The income tax expense reflected a $13 million unfavourable variance versus an anticipated income tax expense of $7 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 $5 million. This was caused by the higher corporate tax rate applicable to the Company's French operations. The Company absorbed a $6 million unfavourable variance related to period 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 reduced the income tax expense by $1 million.

Net earnings (loss)

The Company generated a net loss of $150 million or $1.50 per share for the year ended September 26, 2015, compared to net earnings of $9 million or $0.09 per share for the year ended September 27, 2014.

Comprehensive earnings (loss)

The following table summarizes the impact of items affecting the reported total comprehensive earnings (loss) during the years ended September 2015 and September 2014:

(in millions of dollars)	2014	2015
Net earnings (loss)	9	(150)
Employee future benefit loss	(13)	(5)
Foreign currency translation gain on foreign operations	3	7
Total comprehensive loss	(1)	(148)

During fiscal 2015, the Company recognized a loss of $5 million relating to the increase of the estimated net obligation for employee future benefits. The average discount rate applied to estimate the present value of future obligations increased from 4.03% to 4.04%, thereby reducing the net obligation by $1 million. The return on plan assets exceeded the expected return, decreasing the net obligation by $5 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. This increased the net obligation by $3 million. Changes to demographic assumptions and plan experience increased the net obligation by $8 million.

During fiscal 2014, the Company recognized a loss of $13 million relating to the increase of the estimated net obligation for employee future benefits. The average discount rate applied to estimate the present value of future obligations decreased from 4.60% to 4.03%, thereby increasing the net obligation by $58 million. The return on plan assets exceeded the expected return by $67 million, reducing the net obligation. 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. This increased the net obligation by $9 million. Changes to demographic assumptions and plan experience increased the net obligation by $13 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 fiscal 2015, the currency translation of the French operations generated a gain of $10 million and the currency translation of the U.S. operations generated a loss of $3 million. During fiscal 2014, the currency translation of the French operations generated a gain of $3 million.

Critical accounting estimates

Property, plant and equipment depreciation

The Company records its property, plant and equipment, primarily production buildings and equipment, at cost. Interest costs are capitalized for projects in excess of $1 million that have a duration in excess of one year. Investment tax credits or capital assistance received reduce the cost of the related assets. Property, plant and equipment acquired as a result of a business acquisition are recorded at their estimated fair value. Depreciation of property, plant and equipment is provided over their estimated useful lives, generally on a straight-line basis. The estimated useful lives of property, plant and equipment are based on judgment and the best currently available information. Changes in circumstances can result in the actual useful lives differing from the Company's estimates. Revisions to the estimated useful lives of property, plant and equipment constitute a change in accounting estimate and are dealt with prospectively by amending the amount of future depreciation expense. There were no significant revisions to the estimated useful lives of property, plant and equipment in fiscal 2016 and fiscal 2015.

Impairment of non-financial assets

The Company must review the carrying value of non-financial assets when events or changes in circumstances indicate that the value may have been impaired and is not recoverable through future operations and cash flows. If any such indication exists, then the asset's recoverable amount is estimated. The recoverable amount of a non-financial asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets. An impairment loss is recognized if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. An impairment loss recognized in prior periods is assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized. To estimate future cash flows, the Company uses operating and financial assumptions, primarily those contained in its most recent multi-year operating plan. There were no material asset impairment charges in fiscal 2016 and fiscal 2015.

Employee future benefits

The Company contributes to several defined benefit pension plans, primarily related to employees covered by collective bargaining agreements. The Company also provides post-retirement benefits to retirees, primarily healthcare related. For post-retirement benefits, funding of disbursements is done on a "pay as you go" basis. The Company uses an independent actuarial firm to quantify the amount of pension and post-retirement obligations. The Company, based on its own experience and recommendations from its actuarial firm, evaluates the underlying assumptions on an annual basis. Discount rates utilized to calculate the present value of future obligations are prescribed by IFRS accounting standards. Changes in estimates or assumptions can have a substantial impact on the amount of pension and post-retirement benefit expense, the carrying values on the balance sheet, and, in the case of defined benefit plans, the amount of plan surplus or deficit.

At September 24, 2016, the fair value of defined benefit pension plan assets was $844 million, an amount equal to 89% of the estimated accrued benefit pension obligations of $947 million, generating a shortfall of $103 million. The plan deficit was $76 million at the end of the prior year. The deficit increase of $27 million that occurred over the 12-month period was due to several items as noted in the following table:

(in millions of dollars)	
Deficit – September 26, 2015	(76)
Return on plan assets exceeding obligation interest accretion	54
Employer contributions in excess of current service costs	7
Decrease in discount rate	(94)
Changes to demographic assumptions	6
Deficit – September 24, 2016	(103)

The deficit was decreased by $54 million as the return on plan assets totalled $89 million, exceeding the $35 million of obligation interest accretion. The actual rate of return for fiscal 2016 was approximately 11% as compared to a 4% rate applied to compute interest accretion. The deficit was further reduced by $7 million as employer contributions of $16 million exceeded current service costs of $9 million. The average discount rate applied to estimate the present value of future obligations decreased from 4.04% to 3.24%, thereby increasing estimated future obligations by $94 million. The discount rate is tied to rates applicable to high-quality corporate bonds (AA or higher) in effect at the end of the fiscal year. Changes to demographic assumptions decreased net obligations by $6 million.

Pension expense included in cost of sales in fiscal 2016 was $10 million, as compared to $11 million in the prior year. Based on current assumptions, pension expense in fiscal 2017 is expected to be approximately $12 million. Employer contributions to defined benefit pension plans totalled $16 million in fiscal 2016 as compared to $17 million in fiscal 2015. Employer contributions in fiscal 2017 are expected to be approximately $9 million. There is no assurance that current assumptions will materialize in future periods. The defined benefit pension plans may be unable to earn the satisfactory rates of return. Market driven changes to discount rates and other assumptions may result in changes to anticipated Company contribution amounts.

With regard to other employee future benefit plans, the accrued benefit obligation at September 2016 was $27 million, as compared to $28 million at the end of the prior year. The previously noted decrease in discount rates generated an actuarial loss, increasing the obligation by $1 million. Employer contribution for the employee future benefit plans totalled $3 million in fiscal 2016 as compared to $2 million in fiscal 2015. Based on current assumptions, the amount of employer contributions in fiscal 2017 is expected to be approximately $2 million.

Deferred income taxes

Deferred income tax is calculated using the asset and liability method and recognizes temporary differences between the tax values and the financial statement carrying amounts of balance sheet items as well as certain carry-forward items. The Company only recognizes a deferred income tax asset to the extent that the future realization of the tax asset is probable. This is based on estimates and assumptions as to the future financial performance of the various taxable legal entities in the various tax jurisdictions. At September 24, 2016, the Company had unrecognized deferred tax assets of $598 million, as compared to $589 million at the end of the prior year.

Use of 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 operating earnings to the Company's definition of adjusted EBITDA:

(in millions of dollars)	2015	2016
Operating earnings	31	99
Depreciation and amortization	43	53
Other items	(4)	(4)
Adjusted EBITDA	70	148

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.

(in millions of dollars)	2015	2016
Operating bank loans / Bank indebtedness	114	7
Long-term debt	613	679
Net unamortized financing costs [(1)]	14	20
Current portion of long-term debt	11	22
Less: cash, cash equivalents and restricted cash	(23)	(46)
Net debt	729	682
Long-term liabilities [(2)]	162	183
Shareholders' equity	71	59
Total capitalization	962	924
Net debt to total capitalization ratio	76%	74%

(1) Includes both current and long-term portions
(2) Not adjusted for liabilities held for sale

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

(in millions of dollars)	2015	2016
Net debt	729	682
LTM adjusted EBITDA	70	148
Net debt to LTM adjusted EBITDA (times)	10.4	4.6

Changes in accounting policies and estimates

There were no other new standards impacting the Company's consolidated financial statements in fiscal 2016 and fiscal 2015.

Impact of accounting pronouncements on future reporting periods

IFRS 15 *Revenue from Contracts with Customers*

In May 2014, the IASB released IFRS 15, *Revenue from Contracts with Customers*, which establishes principles for reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. The core principle of IFRS 15 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods and services. IFRS 15 also requires more comprehensive disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers.

IFRS 15 supersedes IAS 11, *Construction Contracts*, IAS 18, *Revenue*, and a number of revenue-related interpretations (IFRIC 13, *Customer Loyalty Programs*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue - Barter Transactions Involving Advertising Service*). IFRS 15 will be effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company has not yet assessed the impact of the adoption of this standard on its consolidated financial statements and does not plan to early adopt the new requirement.

IFRS 9 *Financial Instruments*

In July 2014, the IASB issued the final version of IFRS 9, *Financial Instruments* (IFRS 9). IFRS 9 supersedes IAS 39, IFRIC 9 and earlier versions of IFRS 9 and is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. This standard provides guidance on the classification and measurement of financial liabilities and the presentation of gains and losses on financial liabilities designated at fair value through profit and loss. When an entity elects to measure a financial liability at fair value, gains or losses due to changes in the credit risk of the instrument must be recognized in other comprehensive income. The Company has not yet begun the process of assessing the impact that the new standard will have on its consolidated financial statements and does not plan to early adopt the new requirement.

IFRS 16 *Leases*

In January 2016, the IASB released IFRS 16, *Leases* (IFRS 16), which supersedes IAS 17, *Leases*. IFRS 16 provides a single lessee accounting model, requiring the recognition of assets and liabilities for all leases, unless the lease term is 12 months or less or the underlying asset has a low value. IFRS 16 will be effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. The Company has not yet assessed the impact of the adoption of this standard on its consolidated financial statements.

IAS 7 *Statement of Cash Flows*

In January 2016, the IASB released amendments to IAS 7, *Statement of Cash Flows* (IAS 7). IAS 7 requires entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. IAS 7 will be effective for annual periods beginning on or after January 1, 2017, with early adoption permitted. The Company has not yet assessed the impact of the adoption of this standard on its consolidated financial statements.

There are no other standards or amendments or interpretations of existing standards issued but not yet effective that are expected to have a material impact on our consolidated financial statements.

Significant risks and uncertainties

Product prices

The Company's financial performance is dependent on the selling prices of its products. The markets for lumber, paper pulp and paper products are cyclical and are influenced by a variety of factors. These factors include periods of excess product supply due to industry capacity additions, periods of decreased demand due to weak general economic activity, inventory de-stocking by customers, and fluctuations in currency exchange rates. During periods of low prices, the Company is subject to reduced revenues and margins, resulting in substantial declines in profitability and possibly net losses.

Based on 2016 actual sales volumes, the following table illustrates the approximate annual impact of changes to average Canadian dollar selling prices on adjusted EBITDA and operating earnings:

Selling price sensitivity

	Impact on adjusted EBITDA / operating earnings ($ millions)	Average selling prices ($/unit) Sept. 2016 quarter
SPF lumber - $10/mbf	7	458
Specialty cellulose pulp - $25/tonne	7	1,413
Paper pulp - $25/tonne	12	603
Coated bleached board and newsprint - $25/tonne	9	1,067

The Company's strategy is to develop niche products where possible; maintain low cost, high-quality flexible production facilities; establish and develop long-term relationships with its customers. In addition, the Company may periodically purchase lumber, pulp and newsprint derivative commodity contracts to mitigate the impact of price volatility. At September 24, 2016 and September 26, 2015, the Company did not hold any product derivative commodity contracts.

Foreign exchange

The Company's revenues for most of its products are affected by fluctuations in the relative exchange rates of the US dollar as compared to the Canadian dollar. The Company generated approximately US $715 million of US dollar denominated sales from its Canadian operations in fiscal 2016. As a result, any increase in the value of the US dollar relative to the Canadian dollar increases the amount of revenues realized on sales in local currency. In addition, since business units purchase the majority of their production inputs in local currency, fluctuations in foreign exchange can significantly affect the unit's relative cost position when compared to competing manufacturing sites in other currency jurisdictions. The Company's foreign exchange exposure to fluctuations in the relative exchange rate of the euro compared to the Canadian dollar is not significant as the Tartas specialty cellulose mill's sales and costs are both largely euro denominated.

Based on fiscal 2016 sales volumes, prices and foreign exchange rates, the following table illustrates the impact of a 1% change in the value of the US dollar versus the Canadian dollar. For illustrative purposes, an increase of 1% in the value of the US dollar is assumed. A decrease would have the opposite effects of those shown below:

Foreign exchange sensitivity

(in millions of dollars)	
Sales increase	10
Cost of sales increase	3
Adjusted EBITDA increase	7
Interest expense increase	–
Cash flow increase	7
Loss on translation of US dollar denominated debt	6
Pre-tax earnings increase	1

Direct US dollar purchases of raw materials, supplies and services for the Canadian operations totalled approximately US $213 million in fiscal 2016 and provided a partial offset to the impact on sales. The above does not include the potential indirect impact of currency fluctuations on the cost of items purchased in Canadian dollars.

To potentially further reduce the impact of fluctuations in the value of the US dollar, the Company has a policy which permits hedging of a portion of its US dollar exposure. At September 24, 2016 and September 26, 2015, the Company did not hold any foreign exchange contracts.

Operational risks

The manufacturing activities conducted by the Company's operations are subject to a number of risks including availability and price of fibre, competitive prices for purchased energy, a productive and reliable workforce, compliance with environmental regulations, maintenance and replacement/upgrade of process equipment to manufacture competitive quality products and the requirement to operate the manufacturing facilities at high rates of utilization and efficiency to maintain a competitive cost structure.

Fibre represents the Company's major raw material in the production of wood products, pulp and paper. In Eastern Canada, virgin fibre or timber is sourced primarily by agreements with provincial governments. The agreements are granted for various terms from five to 20 years and are generally subject to regular renewals every five years. The agreements incorporate commitments with respect to sustainable forest management, silvicultural work, forest and soil renewal, as well as cooperation with other forest users. In addition, the Company has undertaken, on a voluntary basis, to have its timber harvesting certified by the Forest Stewardship Council® (FSC®). The Company expects the agreements to be extended as they come up for renewal. Aboriginal groups have claimed substantial portions of land in various provinces over which they claim aboriginal title or in which they have a traditional interest and for which they are seeking compensation from various levels of government. The Company has taken a proactive approach to enhance the economic participation of First Nations in its operations wherever feasible. The Company's operation in France sources its fibre requirements from various private sources, primarily through long-term supply arrangements.

Energy is an important component of mill costs, especially for high-yield pulp mills and newsprint mills. In fiscal 2016, purchased energy costs totalled approximately $72 million, including $31 million for electricity (net of electricity sales), $24 million for fossil fuels and $17 million for wood biomass purchases. Electricity purchases are made primarily from large public utilities, at rates set by regulating bodies. At certain sites, the Company produces electrical energy that is sold to the public utility. In certain jurisdictions, electricity is deregulated, which can lead to greater price volatility. To mitigate the effect of price fluctuations on its financial performance, the Company may employ several strategies, including the securing of longer term supply agreements, the purchase of derivative commodity contracts and operational curtailments in periods of high prices (load shedding). At September 2016 and 2015, the Company did not hold any derivative commodity contracts relating to purchased electricity. Fossil fuels, primarily natural gas, are purchased at market rates. The Company periodically purchases derivative commodity contracts to reduce price volatility. At September 2016 and 2015, the Company did not hold any natural gas derivative commodity contracts.

Nearly all the Company's manufacturing units have a unionized workforce. Over the past 40 years, the Company has successfully negotiated new collective agreements in nearly all instances, with relatively few work stoppages. At many of the Company's facilities, as well as those of the North American industry as a whole, we have seen reductions in employment levels due to technological and process improvements resulting in a workforce with more years of service. This increases the relative costs of pensions and benefits. As at November 2016, the Company had approximately 2,000 employees covered by collective bargaining agreements. There were four agreements covering approximately 260 employees that had expired. An additional five collective agreements covering 705 employees will expire in fiscal 2017. The remaining contracts expire at various dates up to July 2022. The Company anticipates it will reach satisfactory agreements on contracts currently under active negotiations and those expiring in the future.

The Company's operations are subject to industry-specific environmental regulations relating to air emissions, wastewater (effluent) discharges, solid waste, landfill operations, forestry practices, and site remediation. The Company has made significant progress in reducing the environmental impact of its operations. This has occurred as a result of changes in manufacturing processes, the installation of specialized equipment to treat/eliminate the materials being discharged and the implementation of standardized practices such as ISO 14001.

The production of lumber, pulp and paper is capital intensive. The Company estimates that it must invest approximately $35 million to $40 million per year on capital expenditures to avoid degradation of its current operations. As the majority of the funding is provided by cash flow from operations, there can be no assurance that the funds will be available to meet all of the Company's capital expenditure needs. Failure to reinvest can lead to older equipment that is less productive, less reliable and more costly to maintain and operate. The risk of technological obsolescence also increases. Capital expenditure projects can be large in scale, requiring the Company to maintain and/or acquire expertise in the design, planning and execution of major capital projects. There are inherent risks in the capital expenditure process, including the potential for project cost overruns, new equipment that does not perform to anticipated or projected levels, a lengthy start-up period and disruptions to normal operations. Due to relatively low operating cash flow generation over the last several years, the Company has limited capital expenditures. This has led to a "backlog" of capital expenditure projects in several operating facilities.

Because of the relatively high fixed cost component of certain manufacturing processes, especially in pulp and paper, the operations are 24/7 with target efficiency in the 80-85% range. Failure to operate at these levels jeopardizes the continued existence of a mill. Producers are forced to operate the facilities at "full" rate even when demand is not sufficient to absorb all of the output. This can lead to oversupply and lower prices, further increasing the inherent cyclicality of the industry.

Trade restrictions

The Company's manufacturing operations are located primarily in Canada. However, sales into the Canadian market represented only 19% of consolidated sales in fiscal 2016. As such, the Company's financial results are highly dependent on its ability to sell its products into the "export" markets. Tariffs and trade barriers that reduce or prohibit the movement of our products across international borders constitute an ongoing risk. The agreement between Canada and the United States over softwood lumber is a case in point. On October 12, 2006, Canada and the United States entered into an agreement to govern the shipment of Canadian softwood lumber into the United States. Through a combination of quotas and export taxes, the agreement ensured that Canadian producers of softwood lumber remained at a competitive disadvantage versus U.S. producers when it came to accessing the U.S. market. The softwood lumber agreement expired in October 2015. The agreement provided for a one-year moratorium on any trade action after its expiry. The United States government will likely impose or negotiate future measures to limit the flow of Canadian lumber into the U.S. market. China has also imposed antidumping duties on certain viscose grade pulp imports. As a result, the Company has reduced shipments of these grades into China and redirected the volumes into other markets.

Financial risks / debt service

Of the total long-term debt of $716 million, 69% relates to the US $375 million – 9% senior secured notes maturing December 2019. The 9% notes do not require periodic payments for principal amortization. Since the entire principal amount will become due on the maturity date, it is possible the Company will not have the required funds/liquidity to repay the principal due. The Company may require access to the public or private debt markets to issue new debt instruments to replace or partially replace the notes. There is no assurance that the Company will be able to refinance the notes on commercially acceptable terms.

In addition to the above significant risks, the Company's Annual Information Form (AIF) provides a comprehensive list of potential risk factors related to the Company's operations. The AIF can be found on SEDAR at sedar.com.

Evaluation of disclosure controls and procedures

The Company's President and Chief Executive Officer and the Company's Executive Vice President, Finance and Chief Financial Officer have designed, or have caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that material information relating to the Company has been made known to them and that information required to be disclosed in the Company's annual filings, interim filings or other reports filed by it or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified by applicable securities legislation. The Company's President and Chief Executive Officer and the Company's Executive Vice President, Finance and Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's disclosure controls and procedures and have determined, based on that evaluation, that such disclosure controls and procedures are effective at the financial year-end.

Internal control over financial reporting

The Company's President and Chief Executive Officer and the Company's Executive Vice President, Finance and Chief Financial Officer have designed, or have caused to be designed under their supervision, internal control over financial reporting as defined under National Instrument 52-109 — *Certification of Disclosure in Issuer's Annual and Interim Filings*, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Company's President and Chief Executive Officer and the Company's Executive Vice President, Finance and Chief Financial Officer have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's internal control over financial reporting and have determined, based on the criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and on this evaluation, that such internal controls over financial reporting are effective at the financial year-end.

Changes in internal controls

During the period covered by this report, there have been no changes that have materially affected, or are reasonably likely to materially affect Tembec's internal control over financial reporting.

Oversight role of Audit Committee and Board of Directors

The Audit Committee reviews the Company's annual MD&A and related financial statements with management and the external auditors, and recommends their approval to the Board. Management and the internal auditor of the Company also present periodically to the committee a report of their assessment of the Company's internal controls and procedures for financial reporting.

Additional information

Additional information relating to Tembec, including the Annual Information Form, can be found on SEDAR at sedar.com and on the Company's website at tembec.com.

Management Responsibility

The consolidated financial statements and all information in the Financial Report are the responsibility of the Company's management. The consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and, where necessary, include amounts, which are based on best estimates and judgment. Financial information presented throughout the Financial Report is consistent with the data presented in the consolidated financial statements.

A system of internal accounting and administrative controls is maintained by management in order to provide reasonable assurance that transactions are appropriately authorized, assets are safeguarded and financial records are properly maintained to provide accurate and reliable financial statements.

The Company's external auditors are responsible for auditing the consolidated financial statements and giving an opinion thereon. In addition, the Company employs internal auditors to evaluate the effectiveness of its systems, policies and procedures.

The Board of Directors has appointed an Audit Committee, consisting solely of independent directors, which reviews the consolidated financial statements and recommends their approval to the Board of Directors. The Committee meets periodically with the external auditors, the internal auditors and management to review their respective activities and the discharge of each of their responsibilities. Both the external and internal auditors have direct access to the Committee to discuss the scope of their audit work and the adequacy of internal control systems and financial reporting procedures.

The accompanying consolidated financial statements have been audited by the external auditors, KPMG LLP, whose report follows.

JAMES M. LOPEZ
President and Chief Executive Officer

MICHEL J. DUMAS
Executive Vice President, Finance and Chief Financial Officer

November 25, 2016