

Domtar CORP  
Form 10-Q  
May 09, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

**x** **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 30, 2008

OR

**..** **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 001-33164

**DOMTAR CORPORATION**

(Exact name of registrant as specified in its charter)

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**DELAWARE** **20-5901152**  
(State of Incorporation) (I.R.S. Employer Identification No.)  
**395 de Maisonneuve West, Montreal, Quebec H3A 1L6 Canada**

(Address of principal executive offices) (zip code)

**(514) 848-5555**

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

At May 6, 2008, 490,926,252 shares of the issuer's voting common stock were outstanding.

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**DOMTAR CORPORATION**

**FORM 10-Q**

**For the Quarterly Period Ended March 30, 2008**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)****DOMTAR CORPORATION****CONSOLIDATED STATEMENT OF EARNINGS****For the thirteen weeks ended March 30, 2008 and April 1, 2007**

	<b>March 30, 2008</b>	<b>April 1, 2007</b>
	<b>(Unaudited)</b>	
	<b>\$</b>	<b>\$</b>
<i>(in millions of dollars, unless otherwise noted)</i>		
Sales	1,665	1,051
Operating expenses		
Cost of sales, excluding depreciation and amortization	1,342	858
Depreciation and amortization	116	78
Selling, general and administrative	112	41
Closure and restructuring costs	1	3
	1,571	980
Operating income	94	71
Interest expense	39	11
Earnings before income taxes	55	60
Income tax expense	19	11
Net earnings	36	49
Per common share (in dollars) (NOTE 6)		
Net earnings		
Basic	0.07	0.14
Diluted	0.07	0.14
Weighted average number of common and exchangeable shares outstanding (millions)		
Basic	515.5	348.2
Diluted	515.9	348.4

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

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**DOMTAR CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

<i>(in millions of dollars, unless otherwise noted)</i>	March 30, 2008	At December 30, 2007 (Unaudited)
	\$	\$
<b>Assets</b>		
Current assets		
Cash and cash equivalents	57	71
Receivables, less allowances of \$10 and \$9	598	542
Inventories (NOTE 8)	936	936
Prepaid expenses	31	14
Income and other taxes receivable	48	53
Deferred income taxes	181	182
<b>Total current assets</b>	<b>1,851</b>	1,798
Property, plant and equipment, at cost	9,652	9,685
Accumulated depreciation	(4,473)	(4,323)
<b>Net property, plant and equipment</b>	<b>5,179</b>	5,362
Goodwill (NOTE 9)	357	372
Intangible assets, net of amortization (NOTE 10)	105	111
Other assets	107	105
<b>Total assets</b>	<b>7,599</b>	7,748
<b>Liabilities and shareholders' equity</b>		
Current liabilities		
Bank indebtedness	86	63
Trade and other payables	743	765
Income and other taxes payable	33	50
Long-term debt due within one year	17	17
<b>Total current liabilities</b>	<b>879</b>	895
Long-term debt	2,155	2,213
Deferred income taxes	991	1,003
Other liabilities and deferred credits	402	440
Commitments and contingencies (NOTE 13)		
Shareholders' equity		
Common stock		
\$0.01 par value; authorized 2,000,000,000 shares; issued and outstanding: 471,973,262 and 471,169,959 shares, respectively	5	5
Exchangeable shares		
No par value; unlimited shares authorized; issued and held by nonaffiliates: 43,561,065 and 44,252,831 shares, respectively	290	293
Additional paid-in capital	2,581	2,573
Retained earnings	83	47
Accumulated other comprehensive income	213	279

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Total shareholders' equity	<b>3,172</b>	3,197
Total liabilities and shareholders' equity	<b>7,599</b>	7,748

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

**Table of Contents****DOMTAR CORPORATION****CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY <i>(In millions of dollars, unless otherwise noted)</i>	Issued and outstanding common and exchangeable stock (millions of shares)	Common stock, at par	Exchangeable shares	Additional paid-in capital (Unaudited)	Retained earnings	Accumulated other comprehensive income	Total shareholders equity
		\$	\$	\$	\$	\$	\$
<b>Balance at December 30, 2007</b>	515.4	5	293	2,573	47	279	<b>3,197</b>
Conversion of exchangeable shares			(3)	3			
Issuance of common shares	0.1			1			<b>1</b>
Stock-based compensation				4			<b>4</b>
Net earnings					36		<b>36</b>
Cash flow hedge fair value adjustments, net of tax						(5)	<b>(5)</b>
Foreign currency translation adjustments, net of tax						(61)	<b>(61)</b>
<b>Balance at March 30, 2008</b>	<b>515.5</b>	<b>5</b>	<b>290</b>	<b>2,581</b>	<b>83</b>	<b>213</b>	<b>3,172</b>

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

**Table of Contents****DOMTAR CORPORATION****CONSOLIDATED STATEMENT OF CASH FLOWS****For the thirteen weeks ended March 30, 2008 and April 1, 2007**

<i>(In millions of dollars)</i>	March 30, 2008 (Unaudited) \$	April 1, 2007 \$
Operating activities		
Net earnings	36	49
Adjustments to reconcile net earnings to cash flows from operating activities		
Depreciation and amortization	116	78
Deferred income taxes	12	(11)
Closure and restructuring costs		3
Stock-based compensation expense	5	
Other		1
Changes in assets and liabilities, net of effects of acquisition		
Receivables	(55)	(95)
Inventories	(11)	8
Prepaid expenses	(17)	(5)
Trade and other payables	(18)	43
Income and other taxes	(14)	22
Difference between employer pension contributions and pension expense	(5)	(4)
Other assets and other liabilities	(22)	2
Cash flows provided from operating activities	27	91
Investing activities		
Additions to property, plant and equipment	(29)	(14)
Proceeds from disposals of property, plant and equipment	21	
Business acquisitions cash acquired		573
Cash flows provided from (used for) investing activities	(8)	559
Financing activities		
Net change in bank indebtedness	23	20
(Repayment) Drawdown of revolving bank credit facility	(50)	90
Issuance of short-term debt		1,350
Issuance of long-term debt		800
Repayment of short-term debt		(1,350)
Repayment of long-term debt	(6)	
Debt issue costs		(24)
Distribution to Weyerhaeuser prior to March 7, 2007		(1,431)
Other		(1)
Cash flows used for financing activities	(33)	(546)
Net (decrease) increase in cash and cash equivalents	(14)	104
Translation adjustments related to cash and cash equivalents		5
Cash and cash equivalents at beginning of period	71	1
Cash and cash equivalents at end of period	57	110



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Supplemental cash flow information

Net cash payments for:		
Interest	<b>19</b>	
Income taxes	<b>7</b>	<b>3</b>

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

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 30, 2008**

**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**

**(UNAUDITED)**

**NOTE 1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, in the opinion of Management, include all adjustments that are necessary for the fair presentation of Domtar Corporation's (the Company) financial position, results of operations, and cash flows for the interim period presented. Except as disclosed in the Notes to Consolidated Financial Statements, such adjustments are of a normal, recurring nature. Results for the first thirteen weeks of the year may not necessarily be indicative of full year results. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in Domtar Corporation Annual Report on Form 10-K for the fiscal year ended December 30, 2007, as filed with the Securities and Exchange Commission. The December 30, 2007 Consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Certain reclassifications of prior period balances have been made for consistent presentation with the present period.

**BACKGROUND**

Domtar Corporation (the Company or Domtar) was incorporated on August 16, 2006 for the sole purpose of holding the Weyerhaeuser Fine Paper Business (the Business Unit) and consummating the combination of the Business Unit with Domtar Inc. (the Transaction). The Business Unit was operated by Weyerhaeuser Company (Weyerhaeuser) prior to the completion of the Transaction.

On August 22, 2006, Weyerhaeuser and certain wholly owned subsidiaries entered into an agreement with Domtar Inc. providing for:

A series of transfers and other transactions resulting in the Business Unit becoming wholly owned by the Company (the Contribution);

The distribution of shares of the Company to Weyerhaeuser shareholders (the Distribution); and

The combination of Domtar Inc., treated as a purchase for accounting purposes, with the Company.

The Transaction was consummated on March 7, 2007. Domtar Corporation had no operations prior to March 7, 2007 when, upon the completion of the Transaction, it became an independent public holding company that, directly or indirectly through its subsidiaries, owns the Business Unit and Domtar Inc. As of the date of consummation of the Transaction, Domtar Corporation is referred to as the Successor.

For accounting and financial reporting purposes, the Business Unit is considered to be the Predecessor to Domtar Corporation and as a result, its historical financial statements now constitute the historical financial statements of Domtar Corporation. Accordingly, the results reported for the first quarter of 2008 include results of the Successor for the entire period and those reported for the first quarter of 2007 include the results of operations of the Business Unit, on a carve-out basis, for the period from January 1, 2007 to March 6, 2007 and the results of operations of the Successor for the period from March 7, 2007 to April 1, 2007, which represents 26 days of operations.

Domtar Inc. is an integrated manufacturer of uncoated freesheet with pulp, paper and converting facilities in the United States and Canada. Domtar Inc.'s paper business is the most significant segment. In addition to the paper business, Domtar Inc. manufactures and markets lumber and wood-based value-added products and engages in the paper merchants business, which involves the purchasing, warehousing, sale and

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distribution of various paper products made by Domtar Inc. and by other manufacturers.

The Business Unit consists of pulp and paper mills, converting operations, sawmills, forest management licenses and related assets. These facilities are principally engaged in the harvesting of timber and the manufacture, distribution and sale of paper, pulp, and forest products, including softwood lumber.

Although Weyerhaeuser Company does not have a continuing proprietary interest in Domtar Corporation, the Company entered into several agreements with Weyerhaeuser Company and/or certain of its subsidiaries in connection with the Transaction, including a tax sharing agreement, an intellectual property licensing agreement, a transition services agreement, fiber and pulp supply agreements and site services agreements. These agreements enable the Company to continue to operate the Business Unit efficiently following the completion of the Transaction.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 30, 2008**

**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**

**(UNAUDITED)**

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

**ACCOUNTING CHANGE IMPLEMENTED**

In September 2006, the FASB issued SFAS 157, Fair Value Measurements (SFAS 157), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Beginning in fiscal year 2008, the Company has elected to partially adopt SFAS 157 in accordance with FASB Staff Position No. FAS 157-2 (FSP FAS 157-2), which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonrecurring fair value measurements of non financial assets and non financial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis including those measured at fair value in goodwill impairment testing, asset retirement obligations initially measured at fair value, exit and disposal costs initially measured at fair value, and those initially measured at fair value in a business combination.

The implementation of SFAS No. 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on our consolidated financial position and results of operations. The Company is currently assessing the impact of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities on its consolidated financial position and results of operations.

**FUTURE ACCOUNTING CHANGES**

**BUSINESS COMBINATIONS**

In December 2007, the FASB issued Statement No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)). This Statement replaces SFAS No. 141, Business Combinations and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contingent considerations and contractual contingencies based on their fair values as measured on the acquisition date. In addition, SFAS No. 141(R) requires the acquirer to measure the noncontrolling interest in the acquiree at fair value, which will result in recognizing the goodwill attributable to the noncontrolling interest in addition to the goodwill attributable to the acquirer. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Since Statement 141(R) will only be applicable to future business combinations, it will not have a significant effect on the Company's financial position, results of operations or cash flows prior to such acquisitions.

**NONCONTROLLING INTERESTS**

In December 2007, the FASB issued Statement No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS No. 160). SFAS No. 160 amends Accounting Research Bulletin 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This Statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 changes the way the consolidated earnings (loss) statement is presented by requiring consolidated net earnings (loss) to be reported including the amounts attributable to both the parent interest and the noncontrolling interest. The Statement requires disclosure on the face of the consolidated statement of operations of the amounts of consolidated net earnings (loss) attributable to the parent interest and to the noncontrolling interest. SFAS No. 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008.



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**(UNAUDITED)**

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)**

The Company does not expect the initial adoption of SFAS 160 to have a significant effect on the financial position, results of operations and cash flows as the Company has no significant noncontrolling interests.

**DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity's derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. The Company is currently assessing the impact of SFAS No. 161 on its future disclosures.

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**(UNAUDITED)**

**NOTE 3. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

The Company operates within North America, which exposes it to market risk associated with foreign currency exchange rate fluctuations. The Company uses derivative instruments (currency options and foreign exchange forward contracts) to mitigate its exposure to fluctuations in foreign currency exchange rates. The Company's policy is to hedge a significant portion of forecasted purchases in Canadian dollars. The Company does not enter into derivative financial instruments for trading or speculative purposes. The derivative financial instruments are recorded on the Consolidated Balance Sheets at fair value and are included in prepaid expenses and trade and other payables. Fair value measurements for the Company's derivatives are classified under Level 2 because such measurements are determined using published market prices or estimated based on observable inputs such as interest rates, yield curves, spot and future exchange rates.

In 2008, the Company formally documents the relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking the hedge transactions. Foreign exchange forward contracts and currency options contracts used to hedge forecasted purchases in Canadian dollars are designated as cash flow hedges. These contracts are used to hedge forecasted purchases over approximately 12 to 18 months. Changes in the fair value of derivative contracts designated as cash flow hedges are recorded as a component of accumulated other comprehensive income within shareholders' equity, and are recognized in costs of sales in the period in which the hedged transaction occurs.

During the thirteen weeks ended March 30, 2008, the Company recorded an after tax loss of \$5 million in accumulated other comprehensive income, which will be recognized in costs of sales upon maturity of the derivatives during the fifty-two weeks period ending March 29, 2009 at the then current values, which may be different from the March 30, 2008 values. At March 30, 2008, the fair value of these contracts was \$8 million in prepaid expenses and \$8 million in trade and other payables on the Consolidated Balance sheets. The critical terms of the hedging instruments (currency options and foreign exchange forward contracts) and the hedged items match. As a result, there were no material amounts reflected in the consolidated statement of earnings for the thirteen week period ended March 30, 2008 resulting from hedge ineffectiveness.

During the thirteen weeks ended March 30, 2008, the gain recorded in cost of sales in the consolidated statement of earnings related to the change in the fair value of foreign exchange forward contracts designated as cash flow hedges that matured during the period was not material.

In 2007, the Company had derivative instruments that were recorded at fair value in the purchase price allocation. As such, hedge accounting was not permitted and these instruments were recorded at fair value with the resulting gains and losses being reflected in earnings. For the thirteen weeks ended April 1, 2007, the Company recorded nil in earnings. At December 30, 2007, the Company had no derivative instruments outstanding.



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**NOTE 4. BUSINESS COMBINATION**

On March 7, 2007, the Company completed the Transaction to combine the Weyerhaeuser Fine Paper Business with Domtar Inc. The description of the Transaction was disclosed in the Company's Annual Report on Form 10-K for the year ended December 30, 2007.

The following unaudited pro-forma information for the thirteen weeks ended April 1, 2007, presents a summary of consolidated results of operations of the Company as if the Transaction had occurred at the beginning of fiscal 2007. These unaudited pro-forma results have been prepared for comparative purposes only.

<i>For the thirteen weeks ended</i>	<b>April 1, 2007</b>
Sales	\$ 1,624
Operating expenses, excluding depreciation and amortization	1,438
Depreciation and amortization	113
Operating income	73
Earnings before income taxes	31
Net earnings applicable to common shares	26
Basic earnings per share	0.05
Diluted earnings per share	0.05
Basic weighted average number of common shares outstanding (millions)	515.1
Diluted weighted average number of common shares outstanding (millions)	515.7

The above pro-forma information includes a charge of \$29 million for transaction related costs of Domtar Inc. incurred in the first quarter of 2007.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**(UNAUDITED)**

**NOTE 5. STOCK-BASED COMPENSATION**

**OMNIBUS INCENTIVE PLAN**

On February 20, 2008, a second grant under the Omnibus Incentive Plan was provided to executives and other key employees.

*Performance Conditioned Restricted Stock Units ( PCRSUs )*

On February 20, 2008, the Company granted 757,750 PCRSUs having a weighted average grant date fair value of \$6.71 and a weighted average remaining contractual life of approximately 36 months. Each PCRSU is equivalent in value to one common share and is subject to a service condition as well as a performance or market condition. These awards have an additional feature where the ultimate number of units that vest will be determined by the Company's performance results or shareholder return in relation to a predetermined target over the period to vesting. No awards vest when the minimum thresholds are not achieved. The performance measurement date will vary depending on the specific award. Upon vesting, the participants will receive common shares of the Company or in certain instances cash of an equivalent value.

*Restricted Stock Units ( RSUs )*

On February 20, 2008, the Company granted 583,480 RSUs having a weighted average grant date fair value of \$6.71 and a weighted average remaining contractual life of approximately 36 months. The Company will deliver one share of common stock in settlement of each outstanding RSU (including dividend equivalents) that has vested in accordance with the stipulated service conditions. The awards cliff vest at various dates up to February 20, 2011.

*Non-qualified Stock Options*

On February 20, 2008, the Company granted 340,500 stock options, having an exercise price of \$6.71 and grant date fair value of \$2.03. The stock options vest at various dates up to February 20, 2011 if certain market conditions are met in addition to a service period. Upon exercise, the option holders may elect to proceed with a cashless exercise and receive common shares net of the deduction for cashless exercise. The options expire at various dates no later than seven years from the date of grant.

*2008 Stock-based Compensation Expense*

For the thirteen weeks ended March 30, 2008, compensation expense recognized in the Company's results of operations was approximately \$5 million for all outstanding awards (2007 - nil).

The fair value of the stock options granted in 2008 was estimated at the date of grant using a Black-Scholes based option pricing model or an option pricing model that incorporated the market conditions when applicable. The following assumptions were used in calculating the fair value of the options granted.

Dividend yield	0%
Expected volatility	39%

Risk-free interest rate	3%
Expected life	4 years

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**NOTE 6. EARNINGS PER SHARE**

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

<i>For the thirteen weeks ended</i>	<b>March 30, 2008</b>	<b>April 1, 2007</b>
Net earnings	<b>\$ 36</b>	<b>\$ 49</b>
Weighted average number of common and exchangeable shares outstanding (millions)	<b>515.5</b>	348.2
Effect of dilutive securities (millions)	<b>0.4</b>	0.2
Weighted average number of diluted common and exchangeable shares outstanding (millions)	<b>515.9</b>	348.4
Basic net earnings per share (in dollars)	<b>\$ 0.07</b>	\$ 0.14
Diluted net earnings per share (in dollars)	<b>\$ 0.07</b>	\$ 0.14

The following table includes the potential maximum awards of certain awards that were not included in the computation of diluted earnings per share for the thirteen weeks ended March 30, 2008 and April 1, 2007 due to performance targets not being satisfied at the end of the period or were antidilutive:

	<b>March 30, 2008</b>	<b>April 1, 2007</b>
Restricted stock units	<b>1,157,366</b>	
Options	<b>1,096,360</b>	
Performance-based awards	<b>4,320,715</b>	955,946

The calculation of earnings per common share for the thirteen weeks ended March 30, 2008 is based on the weighted-average number of Domtar Corporation common stock outstanding during the period. The calculation for diluted earnings per common share for the thirteen weeks ended March 30, 2008 recognizes the effect of all potential dilutive common stock.

Prior to the Transaction, the Company did not have publicly traded common stock or stock options outstanding. The weighted average number of shares of common stock of Domtar Corporation outstanding for the thirteen weeks ended April 1, 2007 assumes that all such common stock outstanding immediately after the Contribution but before the acquisition of Domtar Inc. were outstanding since January 1, 2007. The effect of dilutive securities for the thirteen weeks ended April 1, 2007 assumes that all replacement stock options of Domtar Corporation were outstanding immediately after the Contribution on March 5, 2007.



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**(UNAUDITED)**

**NOTE 7. PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS****DEFINED CONTRIBUTION PLANS**

The Company has several defined contribution plans and multi-employer plans. The pension expense under these plans is equal to the Company's contribution. For the thirteen weeks ended March 30, 2008, the pension expense was \$4 million (2007 - \$2 million).

**DEFINED BENEFIT PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS**

The Company has several defined benefit pension plans covering substantially all employees. Non-unionized employees in Canada joining the Company participate in defined contribution plans. The defined benefit plans are generally contributory in Canada and non-contributory in the United States. The Company also provides other post-retirement plans to eligible Canadian and US employees; the plans are unfunded and include life insurance programs, medical and dental benefits and short-term and long-term disability programs.

**Components of net periodic benefit cost for****pension plans and other post-retirement****benefit plans****For the thirteen weeks ended**

	<b>March 30, 2008</b>		<b>April 1, 2007</b>	
	<b>Pension Plans</b>	<b>Other post-retirement benefit plans</b>	<b>Pension Plans</b>	<b>Other post-retirement benefit plans</b>
	\$	\$	\$	\$
Service cost	10	1	5	1
Interest expense	21	1	9	1
Expected return on plan assets	(22)		(13)	
Settlement	2		1	
<b>Net periodic benefit cost</b>	<b>11</b>	<b>2</b>	<b>2</b>	<b>2</b>

The Company contributed \$16 million for the thirteen weeks ended March 30, 2008 (2007 - \$6 million) to the pension plans. The Company also contributed \$2 million for the thirteen weeks ended March 30, 2008 (2007 - \$1 million) to the other post-retirement benefit plans.

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**NOTE 8. INVENTORIES**

The following table presents the components of inventories:

	<b>March 30, 2008</b>	<b>December 30, 2007</b>
	<b>\$</b>	<b>\$</b>
Work in process and finished goods	<b>567</b>	586
Raw materials	<b>157</b>	136
Operating and maintenance supplies	<b>212</b>	214
	<b>936</b>	936

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**NOTE 9. GOODWILL**

The carrying value of goodwill and changes in the carrying value are as follows:

	<b>March 30, 2008 \$</b>	<b>December 30, 2007 \$</b>
<b>Balance at beginning of period</b>	<b>372</b>	<b>14</b>
Impairment of goodwill		(4)
Acquisition of Domtar Inc.		300
Effect of foreign currency exchange rate change	(15)	62
<b>Balance at end of period</b>	<b>357</b>	<b>372</b>

The goodwill at both March 30, 2008 and December 30, 2007 is entirely related to the Papers segment.



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**NOTE 10. INTANGIBLE ASSETS**

The following table presents the components of intangible assets:

	Weighted average useful lives	March 30, 2008 \$	December 30, 2007 \$
<b>Intangible assets subject to amortization</b>			
Water rights	40	15	15
Power purchase agreements	25	32	33
Customer relationships	20	9	9
Trade names	7	7	7
Supplier agreements	5	6	6
Natural gas contracts	4	16	17
Cutting rights	Units of production method	27	29
		<b>112</b>	<b>116</b>
Allowance for amortization		(7)	(5)
<b>Total intangible assets</b>		<b>105</b>	<b>111</b>

Amortization expense related to intangible assets for the thirteen weeks ended March 30, 2008 was \$2 million (2007 nil).

Amortization expense for the next five years related to intangible assets is expected to be as follows:

	2008 \$	2009 \$	2010 \$	2011 \$	2012 \$
Amortization expense related to intangible assets	8	8	9	9	5

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**NOTE 11. CLOSURE AND RESTRUCTURING PROVISION**

The following table provides the activity in the closure and restructuring provision.

	<b>March 30, 2008 \$</b>
Balance at beginning of year	<b>83</b>
Severance payments	<b>(7)</b>
Reversal (a)	<b>(23)</b>
Other	<b>(1)</b>
Effect of foreign currency exchange rate change	<b>(1)</b>
<b>Balance at March, 30, 2008</b>	<b>51</b>

(a) Reversal of a provision for a contract assumed in the Transaction as a result of its termination by the counterparty in the first quarter of 2008.

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**NOTE 12. CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)**

<b>For the thirteen weeks ended March 30, 2008 and April 1, 2007</b>	<b>March 30, 2008</b>	<b>April 1, 2007</b>
	<b>(Unaudited)</b>	
	<b>\$</b>	<b>\$</b>
Net earnings	36	49
Other comprehensive income (loss)		
Net derivative losses on cash flow hedges, net of tax	(5)	
Foreign currency translation adjustments, net of tax	(61)	4
<b>Comprehensive (loss) income</b>	<b>(30)</b>	<b>53</b>

The Company's cumulative other comprehensive income includes the following, net of tax:

<b>At</b>	<b>March 30, 2008</b>	<b>December 30, 2007</b>
	<b>(Unaudited)</b>	
	<b>\$</b>	<b>\$</b>
Cash flow hedge fair value adjustments	(5)	
Foreign currency translation adjustments	269	330
Unrecognized losses and prior service costs related to pension and post-retirement benefit plans	(51)	(51)
<b>Cumulative other comprehensive income</b>	<b>213</b>	<b>279</b>

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**NOTE 13. COMMITMENTS AND CONTINGENCIES**

**ENVIRONMENT**

The Company is subject to environmental laws and regulations enacted by federal, provincial, state and local authorities.

During the first quarter of 2006, the Company closed the pulp and paper mill in Prince Albert, Saskatchewan and the Big River sawmill in Saskatchewan due to poor market conditions. The Company has not determined at this time whether the facilities will be reopened, sold or permanently closed. In the event the facilities are permanently closed, the Province of Saskatchewan may require active decommissioning and reclamation at one or both facilities. In the event decommissioning and reclamation is required at either facility, the work is likely to include investigation and remedial action for areas of significant environmental impacts.

The Company is also a party to various proceedings relating to the cleanup of hazardous waste sites under the Comprehensive Environmental Response Compensation and Liability Act, commonly known as Superfund, and similar state laws. The Environment Protection Agency (EPA) and/or various state agencies have notified the Company that it may be a potentially responsible party with respect to other hazardous waste sites as to which no proceedings have been instituted against the Company. The Company continues to take remedial action under its Care and Control Program at a number of former operating sites, especially in the wood preserving sector, due to possible soil, sediment or groundwater contamination. The investigation and remediation process is lengthy and subject to the uncertainties of changes in legal requirements, technological developments and the allocation of liability among potentially responsible parties.

While the Company believes that it has determined the costs for environmental matters likely to be incurred based on known information, the Company's ongoing efforts to identify potential environmental concerns that may be associated with its properties may lead to future environmental investigations. These efforts may result in the determination of additional environmental costs and liabilities, which cannot be reasonably estimated at this time.

An action was commenced by Seaspan International Ltd. (Seaspan) in the Supreme Court of British Columbia, on March 31, 1999 against Domtar Inc. and others with respect to alleged contamination of Seaspan's site bordering Burrard Inlet in North Vancouver, British Columbia including contamination of sediments in Burrard Inlet, due to the presence of creosote. As of July 3, 2002, the parties entered into a partial Settlement Agreement (the Settlement Agreement) which provides that while the agreement is performed in accordance with its terms, the action commenced by Seaspan will be held in abeyance. The Settlement Agreement focused on the sharing of costs between Seaspan and Domtar Inc. for certain remediation of contamination referred to in the plaintiff's claim. The Settlement Agreement does not address all of the plaintiff's claims as that cannot be reasonably determined at this time. Due to the complexity in the implementation of the Settlement, the parties are currently renegotiating the terms and conditions of the Settlement. No party has exercised its right to terminate the Settlement. The Company has recorded a provision for the estimated settlement amount.

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**NOTE 13. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

Domtar Inc. was issued a Request for Response Action ( RFRA ) by the Minnesota Pollution Control Agency ( MPCA ) for the clean-up of tar seeps and soils at a former coal tar distillation plant located in Duluth, Minnesota. On March 27, 1996, the MPCA issued a RFRA to Domtar Inc., Interlake Corp., Allied-Signal, Inc. and Beazer East, Inc. requiring the investigation and potential remediation of a portion of an industrial site located in Duluth, Minnesota, believed to contain contaminated sediments originating from former coke and gas plants and coal tar distillation plants. Domtar Inc. formerly operated one coal tar distillation plant. The total cost of the likely remediation is estimated to be between \$3 million and \$7 million. Final allocation of remediation cost is expected to be determined in the second quarter of 2008. At March 30, 2008, the Company had a provision for the estimated remediation costs.

At March 30, 2008, the Company had a provision of \$117 million for environmental matters and other asset retirement obligations. Additional costs, not known or identifiable, could be incurred for remediation efforts. Based on policies and procedures in place to monitor environmental exposure, management believes that such additional remediation costs would not have a material adverse effect on the Company's financial position, earnings or cash flows.

The following table reflects changes in the reserve for environmental remediation:

	March 30, 2008 \$
Balance at beginning of year	119
Additions	2
Environmental spending	(1)
Effect of foreign currency exchange rate change	(3)
<b>Balance at March, 30, 2008</b>	<b>117</b>

**CONTINGENCIES**

In the normal course of operations, the Company becomes involved in various legal actions mostly related to contract disputes, patent infringements, environmental and product warranty claims, and labor issues. While the final outcome with respect to actions outstanding or pending at March 30, 2008, cannot be predicted with certainty, it is management's opinion that their resolution will not have a material adverse effect on the Company's financial position, earnings or cash flows.

Domtar Inc. is subject to a motion by Joachim Laferrière Électricien Inc., filed in the Quebec Superior Court on January 9, 2006, for authorization to bring a class action suit against Domtar Inc. and others for alleged damages relating to a conspiracy to fix prices of carbonless sheets during the period of January through December 2000 in the Province of Quebec, Canada. The claim seeks estimated compensatory damages in the amount of \$49 million (CDN\$50 million) plus estimated exemplary damages in the amount of \$1 million to \$5 million (CDN\$1 million to CDN\$5 million). Domtar is also subject to a motion by McLay & Company Inc. filed in Ontario Superior Court on January 11, 2006 for authorization to bring a class action suit against Domtar Inc. and others, for alleged inflated prices of carbonless sheets paper during the period of October 1999 through September 2000 in the Province of Ontario, Canada. These class actions have been settled in

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principle for an insignificant amount and are subject to Court approval. The amount had been previously provided for in the purchase price allocation related to the acquisition of Domtar Inc.

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**NOTE 13. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

In the early part of 2006, the Company closed its pulp and paper mill in Prince Albert, Saskatchewan. Certain unionized parties filed a grievance against Weyerhaeuser following the shut down, alleging that certain post-closure actions taken by Weyerhaeuser violated their collective bargaining agreement. In particular, the union disputed the post-closure contracting with a third-party vendor to oversee on-site security at Prince Albert. In connection with the Transaction, the Company has assumed any liability with respect to this grievance. In November 2007, the Company was informed that the Government of the Province of Saskatchewan was not prepared to participate in the financing and redevelopment of the Prince Albert Facility into a Northern Bleached Softwood Kraft ( NBSK ) pulp mill producing 100% Forest Stewardship Council (FSC) certified softwood pulp for the North America and offshore markets, as set forth in the memorandum of understanding signed on September 12, 2007. As such, the Company has not determined whether these previously idled facilities will be reopened, sold or closed. In a separate grievance relating to the closure of the Prince Albert facility, which could result in liability in excess of \$20 million, the union is claiming that it is entitled to the accumulated pension benefits during the actual layoff period because, according to the union, a majority of employees retained still had recall rights during the layoff. The Company is currently evaluating its position with respect to these grievances and cannot be certain that it will not incur liability, which could be material, with respect to these grievances.

On July 31, 1998, Domtar Inc. acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement includes a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of Domtar Inc. in specified circumstances, Domtar Inc. may have to pay up to a maximum of \$117 million (CDN\$120 million), an amount which is gradually declining over a 25-year period. At March 7, 2007, the maximum amount of the purchase price adjustment was \$107 million (CDN\$110 million). No provision was recorded for this potential purchase price adjustment.

On March 14, 2007, the Company received a letter from George Weston Limited (the previous owner of E.B. Eddy and a party to the purchase agreement) demanding payment of \$107 million (CDN\$110 million) as a result of the consummation of the Transaction. On June 12, 2007, an action was commenced by George Weston Limited against Domtar Inc. in the Superior Court of Justice of the Province of Ontario, Canada, claiming that the consummation of the Transaction triggered the purchase price adjustment and sought a purchase price adjustment of \$107 million (CDN\$110 million) as well as additional compensatory damages. The Company does not believe that the consummation of the Transaction triggers an obligation to pay an increase in consideration under the purchase price adjustment and intends to defend itself vigorously against any claims with respect thereto. However, the Company may not be successful in the defense of such claims, and if the Company is ultimately required to pay an increase in consideration, such payment may have a material adverse effect on the liquidity, results of operations and financial condition.

**GUARANTEES AND INDEMNIFICATIONS**

In the normal course of business, the Company offers indemnifications relating to the sale of its businesses and real estate. In general, these indemnifications may relate to claims from past business operations, the failure to abide by covenants and the breach of representations and warranties included in the sales agreements. Typically, such representations and warranties relate to taxation, environmental, product and employee matters. The terms of these indemnification agreements are generally for an unlimited period of time. At March 30, 2008, the Company is unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provisions have been recorded. These indemnifications have not yielded a significant expense in the past.





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**NOTE 14. SEGMENT DISCLOSURES**

The Company operates in the three reportable segments described below. Each reportable segment offers different products and services and requires different technology and marketing strategies. The following summary briefly describes the operations included in each of the Company's reportable segments:

**Papers** represents the aggregation of the manufacturing and distribution businesses, commercial printing and publication, and technical and specialty papers, as well as pulp.

**Paper Merchants** involves the purchasing, warehousing, sale and distribution of various products made by the Company and by other manufacturers. These products include business and printing papers and certain industrial products.

**Wood** comprises the manufacturing and marketing of lumber and wood-based value-added products and the management of forest resources.

The Company evaluates performance based on operating income, which represents sales, reflecting transfer prices between segments at fair value, less allocable expenses before financing expenses and income taxes.

An analysis and reconciliation of the Company's business segment information to the respective information in the financial statements is as follows:

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**NOTE 14. SEGMENT DISCLOSURES (CONTINUED)**

Segment Data For the thirteen weeks ended	March 30, 2008	April 1, 2007
	\$	\$
<b>Sales</b>		
Papers	1,434	955
Paper Merchants	262	76
Wood	63	47
<b>Total for reportable segments</b>	<b>1,759</b>	<b>1,078</b>
Intersegment sales Papers	(88)	(24)
Intersegment sales Wood	(6)	(3)
<b>Consolidated sales</b>	<b>1,665</b>	<b>1,051</b>
<b>Depreciation and amortization</b>		
Papers	110	72
Paper Merchants	3	1
Wood	6	5
<b>Consolidated depreciation and amortization</b>	<b>116</b>	<b>78</b>
<b>Operating income (loss)</b>		
Papers	114	71
Paper Merchants	3	4
Wood	(22)	(4)
Corporate	(1)	
<b>Consolidated operating income</b>	<b>94</b>	<b>71</b>
Interest expense	39	11
<b>Earnings before income taxes</b>	<b>55</b>	<b>60</b>
Income tax expense	19	11
<b>Net earnings</b>	<b>36</b>	<b>49</b>

**Table of Contents****DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MARCH 30, 2008****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

The following information is presented as required under Rule 3.10 of Regulation S-X, in connection with the Company's issuance of debt securities in exchange for outstanding debt securities of Domtar Inc, a wholly-owned subsidiary of the Company. Pursuant to this exchange transaction, the securities that were issued (the "Guaranteed Debt") were fully and unconditionally guaranteed by Domtar Paper Company, LLC, a wholly-owned subsidiary of the Company and the successor to the Weyerhaeuser Fine Paper Business U.S. Operations, and by Domtar Enterprises Inc. (and subsidiaries), a wholly-owned subsidiary of the Company ("Guarantor Subsidiaries"). The Guaranteed Debt will not be guaranteed by certain of Domtar Paper Company LLC's own wholly-owned subsidiaries; including Domtar Delaware Investments Inc, Domtar Delaware Holdings Inc, Domtar Delaware Holdings LLC, Domtar Inc. and Domtar Pulp & Paper Products Inc. (collectively the "Non-Guarantor Subsidiaries").

The following supplemental condensed consolidating financial information sets forth, on an unconsolidated basis, the balance sheets at March 30, 2008 and December 30, 2007 and the statements of earnings (loss), and cash flows for the thirteen weeks ended March 30, 2008 and April 1, 2007 for Domtar Corporation (the "Parent Company"), and on a combined bases for the Guarantor Subsidiaries and, on a combined basis, the Non-Guarantor Subsidiaries. The supplemental condensed consolidating financial information reflects the investments of the Parent Company in the Guarantor Subsidiaries as well as the investments of the Guarantor Subsidiaries in the Non-Guarantor Subsidiaries, in both cases using the equity method. The Parent Company's purchase price allocation adjustments, including applicable intangible assets, arising from the business acquisition in Note 4 have been pushed down to the applicable subsidiary columns.

**Condensed Consolidating Statement Of Earnings (loss) for the thirteen weeks ended March 30, 2008**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (Unaudited)	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
Sales		1,304	722	(361)	1,665
Operating expenses					
Cost of sales, excluding depreciation and amortization		1,054	649	(361)	1,342
Depreciation and amortization		57	59		116
Selling, general and administrative	3	79	30		112
Closure and restructuring costs		1			1
	3	1,191	738	(361)	1,571
Operating income (loss)	(3)	113	(16)		94
Interest expense (revenue)	38	(35)	36		39
Earnings (loss) before income taxes	(41)	148	(52)		55
Income tax expense (benefit)	(17)	60	(24)		19
Share in earnings of equity accounted investees	60	(28)		(32)	

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Net earnings (loss)	36	60	(28)	(32)	36
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**NOTE 15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)****Condensed Consolidating Statement of Earnings (loss) for the thirteen weeks ended April 1, 2007**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (Unaudited)	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
Sales		745	426	(120)	1,051
Operating expenses					
Cost of sales, excluding depreciation and amortization		593	385	(120)	858
Depreciation and amortization		56	22		78
Selling, general and administrative		25	16		41
Closure and restructuring costs		3			3
		677	423	(120)	980
Operating income		68	3		71
Interest expense (revenue)	5	2	4		11
Earnings (loss) before income taxes	(5)	66	(1)		60
Income tax expense (benefit)	(2)	9	4		11
Share in earnings of equity accounted investees	52	(5)		(47)	
Net earnings (loss)	49	52	(5)	(47)	49

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**NOTE 15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)****Condensed Consolidating Balance Sheet March 30, 2008**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (Unaudited)	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Assets</b>					
Current assets					
Cash and cash equivalents		57			57
Receivables		526	72		598
Inventories		618	318		936
Prepaid expenses		4	27		31
Income and other taxes receivable	17	24	7		48
Intercompany accounts		808	941	(1,749)	
Deferred income taxes	5	57	119		181
Total current assets	22	2,094	1,484	(1,749)	1,851
Property, plant and equipment, at cost		5,748	3,904		9,652
Accumulated depreciation		(2,303)	(2,170)		(4,473)
Net property, plant and equipment		3,445	1,734		5,179
Goodwill		92	265		357
Intangible assets, net of amortization			105		105
Investments in affiliates	5,472	1,905	15	(7,392)	
Intercompany advances	2		640	(642)	
Other assets	21	(6)	92		107
Total assets	5,517	7,530	4,335	(9,783)	7,599
<b>Liabilities and shareholders' equity</b>					
Current liabilities					
Bank indebtedness		69	17		86
Trade and other payables	33	416	294		743
Intercompany accounts	472	469	808	(1,749)	
Income and other taxes payable		26	7		33
Long-term debt due within one year	8	5	4		17
Total current liabilities	513	985	1,130	(1,749)	879
Long-term debt	2,120	19	16		2,155

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Intercompany long-term loans		642		(642)	
Deferred income taxes		849	142		991
Other liabilities and deferred credits	2	95	305		402
Shareholders' equity	2,882	4,940	2,742	(7,392)	3,172
Total liabilities and shareholders' equity	5,517	7,530	4,335	(9,783)	7,599

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**NOTE 15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)****Condensed Consolidating Balance Sheet December 30, 2007**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (Unaudited)	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Assets</b>					
Current assets					
Cash and cash equivalents	9	53	9		71
Receivables		452	90		542
Inventories		646	290		936
Prepaid expenses		4	10		14
Income and other taxes receivable		46	7		53
Intercompany accounts		362	384	(746)	
Deferred income taxes	5	57	120		182
Total current assets	14	1,620	910	(746)	1,798
Property, plant and equipment, at cost		5,558	4,127		9,685
Accumulated depreciation		(2,127)	(2,196)		(4,323)
Net property, plant and equipment		3,431	1,931		5,362
Goodwill		85	287		372
Intangible assets, net of amortization			111		111
Investments in affiliates	5,465	1,881	15	(7,361)	
Intercompany advances	2		640	(642)	
Other assets	23	13	69		105
Total assets	5,504	7,030	3,963	(8,749)	7,748
<b>Liabilities and shareholders' equity</b>					
Current liabilities					
Bank indebtedness		54	9		63
Trade and other payables	15	427	323		765
Intercompany accounts	403		343	(746)	
Income and other taxes payable		3	47		50
Long-term debt due within one year	8	9			17
Total current liabilities	426	493	722	(746)	895
Long-term debt	2,173	24	16		2,213



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Intercompany long-term loans		642		(642)	
Deferred income taxes		819	184		1,003
Other liabilities and deferred credits	1	132	307		440
Shareholders' equity	2,904	4,920	2,734	(7,361)	3,197
Total liabilities and shareholders' equity	5,504	7,030	3,963	(8,749)	7,748

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**NOTE 15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)****Condensed Consolidating Statement of Cash Flows for the thirteen weeks ended March 30, 2008**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (Unaudited)	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Operating activities</b>					
Net earnings (loss)	36	60	(28)	(32)	36
Changes in operating and intercompany assets and liabilities and non cash items, included in net earnings (loss)	13	108	(162)	32	(9)
Cash flows provided from (used for) operating activities	49	168	(190)		27
<b>Investing activities</b>					
Additions to property, plant and equipment		(14)	(15)		(29)
Proceeds from disposals of property, plant and equipment			21		21
Increase in long-term advances to related parties		2	167	(169)	
Decrease in long-term advances to related parties	(2)	(167)		169	
Cash flows provided from (used for) investing activities	(2)	(179)	173		(8)
<b>Financing activities</b>					
Net change in bank indebtedness		15	8		23
Repayment of revolving bank credit	(50)				(50)
Repayment of long-term debt	(6)				(6)
Cash flows provided from (used for) financing activities	(56)	15	8		(33)
Net (decrease) increase in cash and cash equivalents	(9)	4	(9)		(14)
Cash and cash equivalents at beginning of period	9	53	9		71
Cash and cash equivalents at end of period		57			57

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**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 30, 2008**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 15. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)****Condensed Consolidating Statement of Cash Flows for the thirteen weeks ended April 1, 2007**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries (Unaudited)	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Operating activities</b>					
Net earnings (loss)	49	52	(5)	(47)	49
Changes in operating and intercompany assets and liabilities and non cash items, included in net earnings (loss)	(73)	225	(157)	47	42
Cash flows provided from (used for) operating activities	(24)	277	(162)		91
<b>Investing activities</b>					
Additions to property, plant and equipment		(9)	(5)		(14)
Business acquisitions cash acquired		573			573
Increase in long-term advances to related parties	638		161	(799)	
Decrease in long-term advances to related parties		(799)		799	
Cash flows provided from (used for) investing activities	638	(235)	156		559
<b>Financing activities</b>					
Net change in bank indebtedness		20			20
Drawdown of revolving bank credit	90				90
Issuance of short-term debt	1,350				1,350
Issuance of long-term debt	800				800
Repayment of short-term debt	(1,350)				(1,350)
Debt issue costs	(24)				(24)
Distribution to Weyerhaeuser prior to March 7, 2007	(1,431)				(1,431)
Other		(1)			(1)
Cash flows provided from (used for) financing activities	(565)	19			(546)
Net increase (decrease) in cash and cash equivalents	49	61	(6)		104
Translation adjustments related to cash and cash equivalents			5		5
Cash and cash equivalents at beginning of year			1		1

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Cash and cash equivalents at end of year	49	61	110
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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ), unless otherwise specified, Domtar Corporation, the Company, Domtar, we, us and our refer to Domtar Corporation and its subsidiaries, as well as its investments. Domtar Corporation's common stock is listed on the New York Stock Exchange and the Toronto Stock Exchange. Except where otherwise indicated, all financial information reflected herein is determined on the basis of accounting principles generally accepted in the United States ( GAAP ). This MD&A should be read in conjunction with Domtar Corporation's unaudited interim consolidated financial statements and notes thereto included elsewhere in this Quarterly Report. You should also read the MD&A in conjunction with the historical financial information contained in our Annual Report on Form 10-K for the year ended December 30, 2007, filed with the Securities and Exchange Commission ( SEC ) on March 25, 2008.

In accordance with industry practice, in this report, the term ton and the symbol ST refer to a short ton, an imperial unit of measurement equal to 0.9072 metric tons. The term tonne and the symbol ADMT refer to an air dry metric ton and the term MFBM refers to million foot board measure. In this report, unless otherwise indicated, all dollar amounts are expressed in U.S. dollars, and the term dollars and the symbol \$ refer to U.S. dollars. In the following discussion, unless otherwise noted, references to increases or decreases in income and expense items, prices, contribution to net earnings, and shipment volume are based on the thirteen week period ended March 30, 2008 as compared to the thirteen week period ended April 1, 2007. The thirteen week periods are also referred to as first quarter of 2008 and 2007, respectively.

**EXECUTIVE SUMMARY**

In the first quarter of 2008, we reported operating income of \$94 million, an increase of \$87 million compared to an operating income of \$7 million in the fourth quarter of 2007. The increase in operating income is primarily due to the absence of an aggregate \$96 million charge for the impairment of property, plant and equipment associated with the reorganization of our Dryden paper mill and the goodwill impairment of our Wood business, recorded in the fourth quarter of 2007, a reversal of a \$23 million provision due to the early termination by a counterparty of an unfavorable contract in the first quarter of 2008 as well as higher average selling prices for pulp and paper, higher shipments for paper, lower synergy and integration costs and the positive impact of a stronger U.S. dollar recorded in the first quarter of 2008. These factors were partially offset by higher costs for fiber, chemicals, energy and freight as well as lower shipments for pulp and lower average selling prices and shipments for our wood products.

Rising energy prices are expected to continue to negatively impact energy-related raw material costs as well as freight costs. The uncoated freesheet market is currently in balance but the risks of a demand decline greater than the long-term trend are now heightened due to a weakening economy. Domtar will continue to monitor its order books and inventory levels and adjust production with customer demand. The costs related to maintenance are expected to increase in the second quarter of 2008 compared to the first quarter of 2008 due to scheduled planned maintenance shutdowns.

These and other factors that affected the quarter-to-quarter comparison of financial results are discussed in the quarter-to-quarter analysis and segment analysis.

**RECENT DEVELOPMENTS**

*Agreement in principle with the Government of Quebec consolidation of forestry activities in Northwestern Quebec*

On May 1, 2008, we announced that we have concluded an agreement in principle with the Minister of Natural Resources and Wildlife of the Province of Quebec, on the allocation of forest harvesting rights in Northern Quebec. This agreement in principle, which is subject to consultations with local elected officials, First Nation communities and other wood business operators of the region, will allow us to execute our consolidation plan, guaranteeing the reallocation of 665,000 net annual cubic meters for the Val d'Or sawmill and 450,000 net annual cubic meters for the Matagami sawmill, providing the required volume to restore the viability of these operations. We are committed to cooperate with the Minister of Natural Resources and Wildlife throughout the consultation process. This agreement in principle also calls for the permanent closure of the Lebel-sur-Quévillon sawmilling operations and the reallocation of 276,000 cubic meters to other sawmill operators in this region. This reallocation of available forest harvesting rights will permit Domtar to add a third shift at the Val d'Or sawmill and a second shift at the Matagami sawmill.

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### *Agreement for the Sale of Wood Business*

On January 7, 2008, we announced that Domtar Inc. and Conifex Inc. had terminated the agreement announced June 22, 2007, relating to the sale of Domtar Inc.'s Wood business. Conifex Inc. was to acquire sawmills and other forest operations situated in Ontario and Quebec. Both parties recognized that the closing conditions had not been met pursuant to the terms of the agreement.

We intend to continue to seek opportunities to maximize the value of these assets as well as pursue initiatives to improve their operational efficiency.

### *Kamloops Fiber Supply*

We entered into a number of fiber supply agreements with Weyerhaeuser pursuant to which Weyerhaeuser had agreed to supply our Kamloops pulp mill with fiber. In February 2008, Weyerhaeuser announced the closure, effective May 12, 2008, of its sawmill in Kamloops, which is a source of fiber for our Kamloops pulp mill. This closure will not have a significant impact on our Kamloops pulp mill operations because under the terms of the supply agreements, Weyerhaeuser will still be responsible for supplying our mill with the agreed upon amount of fiber. However, at March 30, 2008, a significant portion of the fiber supply was replaced through a third party supplier and we expect to replace the remainder of our requirements by the end of the year.

## **THE TRANSACTION**

Domtar Corporation was incorporated on August 16, 2006 for the sole purpose of holding the Weyerhaeuser Fine Paper Business and consummating the combination of the Weyerhaeuser Fine Paper Business with Domtar Inc. (the Transaction). The Weyerhaeuser Fine Paper Business was owned by Weyerhaeuser Company (Weyerhaeuser) prior to the completion of the Transaction. The Transaction was consummated on March 7, 2007. Domtar Corporation had no operations prior to March 7, 2007 when, upon the completion of the Transaction, it became an independent public holding company that, directly or indirectly through its subsidiaries, owns the Weyerhaeuser Fine Paper Business and Domtar Inc. We refer to Domtar Corporation, as of the consummation of the Transaction, as the Successor.

Although Weyerhaeuser does not have a continuing proprietary interest in Domtar Corporation, we have entered into several agreements with Weyerhaeuser and/or some of its subsidiaries in connection with the Transaction, including a tax sharing agreement, an intellectual property licensing agreement, a transition services agreement, fiber and pulp supply agreements and site services agreements. These agreements enable us to continue to operate the Weyerhaeuser Fine Paper Business efficiently following the completion of the Transaction.

The following MD&A of Domtar Corporation covers a period prior to the Transaction. For accounting and financial reporting purposes, the Weyerhaeuser Fine Paper Business is considered to be the Predecessor to Domtar Corporation and as a result, its historical financial statements now constitute the historical financial statements of Domtar Corporation. Accordingly, the results reported for the first quarter of 2008 include results of the Successor for the entire period and those reported for the first quarter of 2007 include the results of operations of the Weyerhaeuser Fine Paper Business, on a carve-out basis, for the period from January 1, 2007 to March 6, 2007 and the results of operations of the Successor for the period from March 7, 2007 to April 1, 2007, which represents 26 days of operations. These historical financial statements may not be indicative of our future performance. See Part I, Item 1A, Risk Factors. The historical financial information of the Predecessor may not be representative of its results if the Weyerhaeuser Fine Paper Business had been operated independently of Weyerhaeuser and, as a result, may not be a reliable indicator of its future results included in our Annual Report on Form 10-K for the year ended December 30, 2007, as previously filed with the SEC.

For more information on the Transaction, refer to Note 1 of the unaudited interim consolidated financial statements included in this Quarterly Report on Form 10-Q.

## **ACCOUNTING FOR THE TRANSACTION**

The Transaction was considered, for accounting purposes, as the acquisition of Domtar Inc. by Domtar Corporation and has been accounted for using the purchase method of accounting. Accordingly, the purchase price was based upon the estimated fair value of Domtar Corporation common stock issued in addition to acquisition costs directly related to the Transaction. Since no quoted market price existed for the shares of Domtar Corporation's common stock, the purchase price was based on the fair value of the net assets acquired on August 23, 2006, the date on which the terms of the Transaction were agreed to and announced. The fair value of Domtar Inc. common shares of \$6.63 per share used in the calculation of the purchase price was based upon the average closing price of Domtar Inc. common shares on the Toronto Stock Exchange for the five trading days beginning August 21, 2006 and ending August 25, 2006, converted at the average daily foreign exchange rate of the Bank of Canada. The number of outstanding Domtar Inc. common shares used in the calculation of the fair value was based on the same periods.



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For more information on the accounting for the Transaction, refer to the information included in our Annual Report on Form 10-K for the year ended December 30, 2007 and Note 4 of our unaudited interim consolidated financial statements included in this Quarterly Report on Form 10-Q.

**OUR BUSINESS**

Our reporting segments correspond to the following business activities: Papers, Paper Merchants and Wood. A description of our business is included in Part I, Item 1, Business of our Annual Report on Form 10-K for the year ended December 30, 2007.

**CONSOLIDATED AND SEGMENTED RESULTS OF OPERATIONS**

The following table includes the unaudited interim consolidated financial results of Domtar Corporation for the first quarter of 2008 and 2007. The first quarter of 2007 consists of the consolidated financial results of the Weyerhaeuser Fine Paper Business, on a carve-out basis, from January 1, 2007 to March 6, 2007 and of the Successor for the period from March 7, 2007 to April 1, 2007.

<b>FINANCIAL HIGHLIGHTS</b> <i>(In millions of U.S. dollars, unless otherwise noted)</i>	<b>Thirteen weeks ended</b>	
	<b>March 30, 2008</b>	<b>April 1, 2007</b>
Sales	<b>\$ 1,665</b>	\$ 1,051
Operating income	<b>94</b>	71
Net earnings	<b>36</b>	49
Net earnings per common share (in dollars) <sup>1</sup> :		
Basic	<b>0.07</b>	0.14
Diluted	<b>0.07</b>	0.14
Operating income (loss) per segment:		
Papers	<b>\$ 114</b>	\$ 71
Paper Merchants	<b>3</b>	4
Wood	<b>(22)</b>	(4)
Corporate	<b>(1)</b>	
Total	<b>\$ 94</b>	\$ 71
	<b>At March 30, 2008</b>	<b>At December 30, 2007</b>
Total assets	<b>\$ 7,599</b>	\$ 7,748
Total long-term debt, including current portion	<b>\$ 2,172</b>	\$ 2,230

- 1 Refer to Note 6 of the unaudited interim consolidated financial statements included in Item 1, for more information on the calculation of net earnings per common share.

**THIRTEEN WEEK PERIOD ENDED MARCH 30, 2008 VERSUS****THIRTEEN WEEK PERIOD ENDED APRIL 1, 2007****Sales**

Sales for the first quarter of 2008 amounted to \$1,665 million, an increase of \$614 million, or 58%, from sales of \$1,051 million in the first quarter of 2007 primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding sales of \$885 million attributable to Domtar Inc. for the first quarter of 2008 and \$238 million for the 26 days of operations in the first quarter of 2007, sales for the first quarter of 2008 amounted to \$780 million, a decrease of \$33 million compared to sales of \$813 million for the first quarter of 2007. The decrease was mainly attributable to lower shipments for pulp and paper, when excluding paper shipments attributable to Domtar Inc. as well as lower average selling prices for



wood products. These factors were partially offset by higher average selling prices for pulp and paper.

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Domtar Inc.'s sales for the first quarter of 2008 amounted to \$885 million. Domtar Inc.'s sales were impacted by lower shipments for wood products and lower average selling prices for lumber, partially offset by higher average selling prices for pulp and paper and higher shipments for pulp.

### **Cost of Sales, Excluding Depreciation and Amortization**

Cost of sales, excluding depreciation and amortization, amounted to \$1,342 million in the first quarter of 2008, an increase of \$484 million, or 56%, compared to cost of sales in the first quarter of 2007 primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding cost of sales of \$705 million attributable to Domtar Inc. for the first quarter of 2008 and \$207 million for the 26 days of operations for the first quarter of 2007, cost of sales in the first quarter of 2008 amounted to \$637 million, a decrease of \$14 million compared to cost of sales of \$651 million for the first quarter of 2007. This decrease was mainly attributable to lower shipments for pulp and paper, when excluding paper shipments attributable to Domtar Inc., lower costs of freight and the absence of an environmental provision of \$5 million recorded in the first quarter of 2007. These factors were partially offset by higher costs for chemicals and fiber, the stronger Canadian dollar as well as higher costs for energy and maintenance.

Domtar Inc.'s cost of sales, excluding depreciation and amortization, for the first quarter of 2008, amounted to \$705 million, which was impacted by the reversal of a \$23 million provision due to the early termination by the counterparty of an unfavorable contract in the first quarter of 2008 and lower shipments for all of its major products except pulp, partially offset by higher costs for chemicals, fiber and energy and the impact of a stronger Canadian dollar.

### **Depreciation and Amortization**

Depreciation and amortization amounted to \$116 million in the first quarter of 2008, an increase of \$38 million, or 49%, compared to depreciation and amortization in the first quarter of 2007, primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding depreciation and amortization of \$40 million attributable to Domtar Inc. for the first quarter of 2008, and \$7 million for the 26 days of operations for the first quarter of 2007, depreciation and amortization in the first quarter of 2008 amounted to \$76 million, an increase of \$5 million compared to depreciation and amortization of \$71 million in the first quarter of 2007. This increase is primarily due to the negative impact of a stronger Canadian dollar.

Domtar Inc.'s depreciation and amortization for the first quarter of 2008 amounted to \$40 million, which was impacted by the completion of our purchase price allocation in the fourth quarter of 2007 affecting the valuation of property, plant and equipment acquired in the Transaction.

### **Selling, General and Administrative**

SG&A expenses increased by \$71 million in the first quarter of 2008 compared to the first quarter of 2007, primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding SG&A of \$71 million attributable to Domtar Inc. for the first quarter of 2008 and \$10 million for the 26 days of operations for the first quarter of 2007, SG&A in the first quarter of 2008 amounted to \$41 million, an increase of \$10 million compared to SG&A of \$31 million for the first quarter of 2007. This increase in SG&A is mostly due to stock-based compensation costs, integration and optimization costs, as well as higher pension expense, partially offset by the elimination of the corporate charges from Weyerhaeuser.

Domtar Inc.'s SG&A amounted to \$71 million for the first quarter of 2008, and included higher costs related to stock-based compensation, integration and optimization, and pension expense.

### **Operating Income**

Operating income in the first quarter of 2008 amounted to \$94 million, an increase of \$23 million, or 32%, compared to operating income of \$71 million in the first quarter of 2007. Excluding operating income of \$68 million attributable to Domtar Inc. for the first quarter of 2008 and \$14 million for the 26 days of operations for the first quarter of 2007, operating income in the first quarter of 2008 amounted to \$26 million, a decrease of \$31 million compared to operating income of \$57 million for the first quarter of 2007. The decrease in operating income was mostly attributable to the factors mentioned above.

Domtar Inc.'s operating income for the first quarter of 2008 amounted to \$68 million and was impacted by the factors mentioned above.



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### **Interest Expense**

We incurred \$39 million of interest expense for the first quarter of 2008, an increase of \$28 million compared to interest expense of \$11 million for the first quarter of 2007. This increase is due to financing expense in the first quarter of 2007 including only 26 days of interest resulting from both the Transaction financing and interest on Domtar Inc. debt, partially offset by lower interest rates in the first quarter of 2008 when compared to the first quarter of 2007.

### **Income Taxes**

Income tax expense amounted to \$19 million in the first quarter of 2008, which was comprised of current tax expense of \$7 million and deferred tax expense of \$12 million. We made income tax payments, net of refunds, of \$7 million during the first quarter of 2008. Our forecasted tax rate for 2008 is approximately 41% compared to an effective tax rate of 29% for full year 2007. In the first quarter of 2008, our effective tax rate was 35% due to a terminated contract. Excluding a \$15 million recovery related to statutory rate changes, the effective tax rate was 44% for full year 2007. Since most of our Canadian operations continue to experience operating losses, our forecasted tax rate is impacted by the weighted-average effect of both domestic and foreign statutory tax rates. Due to the volatility of foreign exchange rates, we are unable to estimate the impact of future changes in exchange rates on our forecasted tax rate for 2008.

### **Net Earnings**

Net earnings amounted to \$36 million (\$0.07 per common share on a diluted basis) in the first quarter of 2008, a decrease of \$13 million compared to net earnings of \$49 million (\$0.14 per common share on a diluted basis) in the first quarter of 2007 in part due to the acquisition of Domtar Inc. on March 7, 2007. Excluding net earnings attributable to Domtar Inc. of \$42 million in the first quarter of 2008 and \$7 million in the first quarter of 2007, net loss in the first quarter of 2008 amounted to \$6 million, a decrease of \$48 million from net earnings of \$42 million in the first quarter of 2007. This decrease in net earnings was mainly attributable to the factors mentioned above.

**Table of Contents****PAPERS**

SELECTED INFORMATION <i>(In millions of U.S. dollars, unless otherwise noted)</i>	Thirteen weeks ended	
	March 30, 2008	April 1, 2007
<b>Sales</b>		
Total sales	\$ 1,434	\$ 955
Intersegment sales	(88)	(24)
	\$ 1,346	\$ 931
<b>Operating income</b>	<b>114</b>	<b>71</b>
<b>Shipments</b>		
Paper (in thousands of ST)	1,205	871
Pulp (in thousands of ADMT)	347	249
<b>Benchmark prices<sup>1</sup> :</b>		
20- lb repro bond, 92 bright (copy) (\$/ton)	\$ 1,007	\$ 930
50-lb offset, rolls (\$/ton)	860	810
Coated publication, no.5, 40 lb Offset, rolls (\$/ton)	900	778
Pulp NBSK U.S. market (\$/ADMT)	880	790
Pulp NBHK Japan market(\$/ADMT)	715	640

<sup>1</sup> Source: Pulp & Paper Week. As such, these prices do not necessarily reflect our transaction prices.

<sup>2</sup> Based on Pulp and Paper Week's Southern Bleached Hardwood Kraft pulp prices for Japan, increased by an average differential of \$15/ADMT between Northern and Southern Bleached Hardwood Kraft pulp prices.

**Sales and Operating Income***Sales*

Sales in our Papers business amounted to \$1,346 million in the first quarter of 2008, an increase of \$415 million, or 45%, compared to sales of \$931 million in the first quarter of 2007, primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding sales attributable to Domtar Inc. of \$575 million in the first quarter of 2008 and \$143 million for the 26 days of operations in the first quarter of 2007, sales in the first quarter of 2008 amounted to \$771 million, a decrease of \$17 million compared to sales of \$788 million in the first quarter of 2007. The decrease of \$17 million in sales is attributable to a decrease in shipments of paper and pulp, excluding shipments related to Domtar Inc., of approximately 4% and 6%, respectively, reflecting softer market demand for uncoated freesheet paper. These factors were partially offset by higher average selling prices for paper and pulp, reflecting the price increases implemented toward the end of 2007 and a portion of the price increases implemented in February 2008.

Domtar Inc.'s sales for the first quarter of 2008 amounted to \$575 million and were impacted by the same factors mentioned above, except that shipments of pulp and paper were flat.

*Operating Income*

Operating income in our Papers business amounted to \$114 million in the first quarter of 2008, an increase of \$43 million compared to operating income of \$71 million in the first quarter of 2007, in part due to the acquisition of Domtar Inc. on March 7, 2007. Excluding operating income attributable to Domtar Inc. of \$81 million in the first quarter of 2008 and \$10 million for the 26 days of operations in the first quarter of 2007, operating income in the first quarter of 2008 amounted to \$33 million, a decrease of \$28 million compared to operating income of \$61 million in the first quarter of 2007. The decrease of \$28 million in operating income is mostly attributable to higher costs for fiber, higher costs for chemicals, mostly caustic soda, sodium chlorate, sulfuric acid and starch, as well as higher energy costs, lower shipments for pulp and paper and the negative impact of a stronger Canadian dollar. In addition, our planned maintenance downtime costs were higher in the first quarter of 2008 when compared to the first quarter of 2007, reflecting a maintenance shutdown period that was longer than expected at one of our pulp mills. These factors were partially offset by higher average selling prices for pulp and paper.



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## **Table of Contents**

Domtar Inc.'s operating income totaled \$81 million for the first quarter of 2008 and was impacted by higher costs for fiber and chemicals as well as energy and freight, lower shipments for paper and the negative impact of a stronger Canadian dollar, partially offset by a reversal of a \$23 million provision due to the early termination by the counterparty of an unfavorable contract in the first quarter of 2008 as well as higher average selling prices for paper and pulp.

### **Pricing Environment**

In our Papers business, our overall average sales prices increased in the first quarter of 2008 compared to the first quarter of 2007. Our average sales price for copy 20 lb sheets and offset 50 lb rolls was higher by \$104/ton and \$42/ton, or 11% and 5%, respectively, in the first quarter of 2008 compared to the first quarter of 2007, reflecting the price increases implemented toward the end of 2007 and a portion of the price increases implemented in February 2008.

Our average sales prices for both Northern Bleached Softwood Kraft ( NBSK ) pulp and Northern Bleached Hardwood Kraft ( NBHK ) pulp increased by \$87/tonne and \$113/tonne, or 13% and 20%, respectively, in the first quarter of 2008 compared to the first quarter of 2007, reflecting the price increases implemented toward the end of 2007 and a portion of the price increases implemented in February 2008.

### **Operations**

#### *Shipments*

Our paper shipments, excluding shipments related to Domtar Inc., decreased by 31,000 tons, or 4%, in the first quarter of 2008 compared to the first quarter of 2007 primarily due to the reorganization of our Dryden paper mill announced in the fourth quarter of 2007, which began in January 2008, an increase in planned maintenance downtime at one of our mills as well as softer market demand for uncoated freesheet paper.

Our pulp trade shipments, excluding shipments related to Domtar Inc., decreased by 13,000 tonnes, or 6%, in the first quarter of 2008 compared to the first quarter of 2007 primarily due to a planned maintenance shutdown at one of our pulp mills as well as a lack of availability of both bulk ships and containers impacting our pulp exports.

#### *Labor*

A collective agreement expired in April 2004 for our Lebel-sur-Quévillon pulp mill affecting approximately 350 employees. Negotiations have ceased and the mill has been closed for an indefinite period since November 2005.

Negotiations for the renewal of the collective agreement that expired in November 2007 for our Ashdown mill (affecting approximately 900 employees) began in October 2007 and are still ongoing. Negotiations for the renewal of the collective agreement that expired in August 2007 for our Woodland mill began in November 2007 and are ongoing as well.

In May 2008, we signed a 4-year umbrella agreement with the United Steel Workers, affecting approximately 4,000 employees at 10 U.S. locations. This agreement only covers certain economic elements and all other bargaining will take place at the respective locations, when the collective bargaining agreements will come to renewal. The parties have agreed not to strike or to lock-out during the terms of the respective locations and renewal agreements.

#### *Closure and Restructuring*

In December 2007, we announced the reorganization of our Dryden facility as well as the closure of our Port Edwards mill, effective in the first and second quarters of 2008, respectively. These measures will result in the curtailment of approximately 336,000 tons of paper capacity per year and will affect approximately 625 employees. The reorganization of our Dryden facility was successfully implemented in the first quarter of 2008.

In July 2007, we announced the closure of two paper machines, one at our Woodland pulp and paper mill and another at our Port Edwards pulp and paper mill as well as the closure of our Gatineau paper mill and our Ottawa converting center, effective October 2007. In total, these closures resulted in the curtailment of approximately 284,000 tons of paper capacity per year and affected approximately 430 employees.

#### *Other*

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Our air permit for our Kamloops pulp mill required that the facility reduce air emissions of particulate matter by December 31, 2007. Compliance with the permit requirements is likely to require approximately \$25 million in capital expenditures over the next 5 years. The Province of British Columbia agreed to extend the deadline for the compliance under specific conditions for a period of 5 years. We are currently evaluating our options. If we do not have sufficient resources to make necessary capital expenditures or decide not to further invest in the facility, the facility may not be able to operate after the extension without significantly curtailing the output, which could increase our production costs.

On September 12, 2007, we signed a memorandum of understanding with the Province of Saskatchewan regarding a plan for the redevelopment of the Prince Albert facility. On November 30, 2007, we were informed that the Government of Saskatchewan was not prepared



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to participate in the financing and redevelopment of the Prince Albert facility into a NBSK pulp mill producing 100% Forest Stewardship Council ( FSC ) certified softwood pulp for the North American and offshore markets. As of March 30, 2008, we had not determined whether this previously idled facility will be reopened, sold or closed.

Our Lebel-sur-Quévillon pulp mill, which was part of our acquisition of Domtar Inc., was indefinitely closed in the fourth quarter of 2005 due to unfavorable economic conditions. As of March 30, 2008, the Lebel-sur-Quévillon pulp mill remains indefinitely idled due to continuing unfavorable economic factors such as high wood fiber, energy and transportation costs, a strong Canadian dollar and uncompetitive labor costs.

**Table of Contents****PAPER MERCHANTS**

<b>SELECTED INFORMATION</b> <i>(In millions of U.S. dollars)</i>	<b>Thirteen weeks ended</b>	
	<b>March 30, 2008</b>	<b>April 1, 2007</b>
<b>Sales</b>	<b>\$ 262</b>	<b>\$ 76</b>
Operating income	3	4
<b>Sales and Operating Income</b>		

*Sales*

Our Paper Merchants business generated sales of \$262 million for the first quarter of 2008, an increase of \$186 million when compared to sales of \$76 million for the 26 days of operations in the first quarter of 2007. The Predecessor had no Paper Merchants operations and as a result, sales for the first quarter of 2007 represent only the 26 days of sales, from March 7, 2007, to April 1, 2007.

*Operating Income*

Operating income amounted to \$3 million for the first quarter of 2008, a decrease of \$1 million when compared to operating income of \$4 million for the 26 days of operations in the first quarter of 2007. The Predecessor had no Paper Merchants operations and as a result, operating income for the first quarter of 2007 represents 26 days of operations, from March 7, 2007 to April 1, 2007.

Our Paper Merchants operations in the first quarter of 2008 were positively impacted by an increase in deliveries but negatively impacted by an increase in costs, including an increase in allowance for doubtful accounts.

**Operations***Labor*

We have collective agreements covering six locations in the U.S. and five locations in Canada that will expire between December 2008 and December 2010.

**Table of Contents****WOOD**

SELECTED INFORMATION <i>(In millions of U.S. dollars, unless otherwise noted)</i>	Thirteen weeks ended	
	March 30, 2008	April 1, 2007
Sales	\$ 63	\$ 47
Intersegment sales	(6)	(3)
	57	44
Operating loss	(22)	(4)
Shipments (millions of FBM)	160	88
Benchmark prices <sup>1</sup> :		
Lumber G.L. 2x4x8 stud (\$/MFBM)	\$ 277	\$ 317
Lumber G.L. 2x4 R/L no. 1 & no. 2 (\$/MFBM)	291	332

<sup>1</sup> Source: Random Lengths. As such, these prices do not necessarily reflect our sales prices.

**Sales and Operating Loss***Sales*

Sales in our Wood business amounted to \$57 million in the first quarter of 2008, an increase of \$13 million, or 30%, compared to sales of \$44 million in the first quarter of 2007, primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding sales attributable to Domtar Inc. of \$48 million in the first quarter of 2008 and \$19 million for the 26 days of operations in the first quarter of 2007, sales in the first quarter of 2008 amounted to \$9 million, a decrease of \$16 million compared to sales of \$25 million in the first quarter of 2007. The decrease in sales of \$16 million is attributable to lower average selling prices due in part to the slowdown in the U.S. housing industry as well as lower sales of wood chips.

Domtar Inc.'s sales amounted to \$48 million in the first quarter of 2008 and were impacted by lower shipments and lower average selling prices.

*Operating Loss*

Operating loss in our Wood business amounted to \$22 million in the first quarter of 2008, an increase in operating loss of \$18 million compared to an operating loss of \$4 million in the first quarter of 2007 primarily due to the acquisition of Domtar Inc. on March 7, 2007. Excluding an operating loss attributable to Domtar Inc. of \$15 million in the first quarter of 2008 and nil for the 26 days of operations in the first quarter of 2007, the operating loss in the first quarter of 2008 amounted to \$7 million, an increase of \$3 million compared to an operating loss of \$4 million in the first quarter of 2007. The increase in operating loss of \$3 million is attributable to lower average selling prices and the negative impact of a stronger Canadian dollar.

Domtar Inc.'s operating loss totaled \$15 million for the first quarter of 2008. Factors impacting Domtar Inc.'s operating loss include lower average selling prices and lower shipments for lumber and chips and the negative impact of a stronger Canadian dollar.

**Pricing Environment**

Our average sales price for Great Lakes 2x4 stud decreased by \$40/MFBM, or 15%, and our average sales price for Great Lakes 2x4 random length decreased by \$41/MFBM, or 14%, in the first quarter of 2008 compared to the first quarter of 2007.

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### **Operations**

#### *Shipments*

Our lumber and wood shipments in the first quarter of 2008, excluding shipments of Domtar Inc., increased by 4 MFBM, or 1%, compared to shipments of the first quarter of 2007, however we continued to be negatively impacted by the slowdown in the U.S. housing industry.

#### *Labor*

In January 2008, a five year collective agreement was ratified by the members at our Nairn Center sawmill (affecting approximately 105 employees).

A collective agreement expired in June 2007 for our Sainte-Marie sawmill. Negotiations for the renewal of this collective agreement (affecting approximately 70 employees) began in August 2007 and are still ongoing.

#### *Fiber supply*

The Province of Quebec adopted legislation, which became effective April 1, 2005, that reduced allowable wood-harvesting volumes by an average of 20% on public lands and 25% on territories covered by an agreement between the Government of Quebec and Cree First Nations. As a result, the amount of fiber, primarily softwood fiber, we are permitted to harvest annually under our existing licenses from the Quebec government, was reduced by approximately 500,000 cubic meters to approximately 1.8 million cubic meters, reflecting a 21% reduction. The Chief Forester of Quebec has proposed a further reduction of 55,000 cubic meters, or 3%, of the total softwood annual allowable cut of forests managed by us. The reduction should be effective starting in the second quarter of 2008 and would significantly affect the supply of fiber for our Northern Quebec softwood sawmills. On May 1, 2008, we announced that we have concluded an agreement in principle with the Minister of Natural Resources and Wildlife, on the reallocation of forest harvesting rights in Northern Quebec. The proposed reallocation of volume will be for a period of 5 years and will allow us to execute our consolidation plan, guaranteeing the reallocation of 665,000 net annual cubic meters for our Val d'Or sawmill and 450,000 net annual cubic meters for the Matagami sawmill. This agreement in principle is subject to consultations with local elected officials, First Nation communities and other wood business operators of the region. The agreement in principle also calls for the permanent closure of Lebel-sur-Quévillon sawmilling operations representing approximately 276,000 net annual cubic meters. In the event that our Lebel-sur-Quévillon sawmill is close, it will impact approximately 215 employees and represent approximately \$4 million of severance costs. Other than the severance costs, our financial results should not be significantly impacted by this closure.

The reduction in harvest volume would also result in a corresponding increase in the unit cost of wood delivered to the sawmills. As a result of the strength of the Canadian dollar against the U.S. dollar, low lumber prices and other factors, a significant portion of our wood harvesting operations in Quebec have been shut down and all but two, Val d'Or and Matagami, of these facilities related to such operations have been closed indefinitely. In June 2007, we restarted our Val d'Or sawmill (annual capacity of approximately 160 million board feet), as a result of a new contract for our chips and more favorable economic conditions, and in January 2008, we restarted our Matagami sawmill which has an annual capacity of approximately 100 million board feet.

On October 1, 2007, Domtar Inc. received a written notice from the Minister of Natural Resources and Wildlife for the province of Quebec purporting to revoke, effective September 14, 2007, Domtar Inc.'s forest license rights relating to its Grand-Remous and Malartic sawmills representing approximately 567,000 cubic meters of fiber on an annual basis. While we are currently seeking the reinstatement of these license rights through formal legal proceedings, there is no assurance that we will be successful and we may lose these forest license rights permanently.

#### *Other*

In January 2008, we announced that Domtar Inc. and Conifex Inc. agreed to terminate the agreement entered into in June 2007 to sell substantially all of our Wood business to Conifex Inc. See Recent Developments, Agreement for the Sale of Wood Business for further details.

In the first quarter of 2006, we indefinitely closed our Big River and 51% owned Wapawekka, Saskatchewan sawmills due to the closure of our Prince Albert, Saskatchewan facility and poor market conditions. These previously idled facilities are currently not in operation. At March 30, 2008, we had not determined whether these facilities will be reopened, sold or closed. In the event that our Big River, Saskatchewan sawmill is closed, the Province of Saskatchewan may require active decommissioning and reclamation at the facility, which would likely include investigation and remedial action for areas of significant environmental impact.

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In January 2007, due to the difficult market conditions that had prevailed in the wood sector in recent months, including the slowdown of the U.S. housing industry and the new softwood lumber agreement, we announced the indefinite closure of our White River sawmill which became effective prior to the end of the second quarter of 2007. The closure impacted approximately 140 permanent positions and reduced our production capacity by 110 million board feet of lumber.

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### **STOCK-BASED COMPENSATION EXPENSE**

In February 2008, a number of new equity awards were granted, consisting of performance conditioned restricted stock units, restricted stock units and non-qualified stock options, which are subject to a variety of service, performance and market conditions.

For the first quarter of 2008, compensation expense recognized in our results of operations was approximately \$5 million for all of the outstanding awards and nil for the first quarter of 2007. Compensation costs for performance awards are based on management's best estimate of the ultimate performance measurement.

### **LIQUIDITY AND CAPITAL RESOURCES**

Our principal cash requirements are for ongoing operating costs, working capital and capital expenditures, as well as principal and interest payments on our debt. We expect to fund our liquidity needs primarily with internally generated funds from our operations and, to the extent necessary, through borrowings under our revolving credit facility. We also have the ability to fund liquidity requirements through new financing, subject to satisfactory market conditions and credit ratings.

Our ability to make payments on and to refinance our indebtedness, including debt we have incurred under the Credit Agreement and new Domtar Corporation notes, and to fund working capital, capital expenditures, debt service and investments, will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our Credit Agreement and debt indenture as well as conditions in future indebtedness may impose various restrictions and covenants on us that could limit our ability to respond to market conditions, to provide for unanticipated capital investments or to take advantage of business opportunities.

#### **Operating Activities**

Cash flows provided from operating activities totaled \$27 million in the first quarter of 2008, a \$64 million decrease compared to cash flows provided from operating activities of \$91 million in the first quarter of 2007. This decrease in cash flows provided from operating activities reflects a decrease in profitability as well as an increase in requirements for working capital. The first quarter of the year is typically impacted by seasonally high requirements for working capital. Our operating cash flow requirements are primarily for salaries and benefits, the purchase of fiber, energy and raw materials and other expenses such as property taxes.

#### **Investing Activities**

Cash flows used for investing activities in the first quarter of 2008 amounted to \$8 million, a \$567 million decrease compared to cash flows provided from investing activities in the first quarter of 2007. Excluding acquired cash of \$573 million in the first quarter of 2007, cash flows used for investing activities was \$14 million. The \$6 million decrease in cash flows used for investing activities, when excluding cash acquired, is primarily related to higher capital spending, in part due to the acquisition of Domtar Inc., partially offset by the proceeds from the disposal of certain property, plant and equipment. We intend to limit our annual capital expenditures to below 60% of depreciation.

#### **Financing Activities**

Cash flows used for financing activities totaled \$33 million in the first quarter of 2008 compared to cash flows used for financing activities of \$546 million in the first quarter of 2007. This \$513 million decrease in cash flows used for financing activities is mainly attributable to the distribution to Weyerhaeuser of \$1,431 million upon the acquisition of Domtar Inc. in the first quarter of 2007, which was partially offset by borrowings under our new Credit Agreement of \$800 million (consisting of an \$800 million tranche B term loan facility) plus an additional \$90 million of borrowings under the revolving credit facility in the first quarter of 2007. During the first quarter of 2008, we repaid \$50 million under our revolving credit facility, redeemed the remaining Canadian debentures for \$3 million and repaid \$2 million under the tranche B term loan facility.

#### **Capital Resources**

Net indebtedness, consisting of bank indebtedness and long-term debt, net of cash and cash equivalents, was \$2,201 million at March 30, 2008, as compared to \$2,222 million at December 30, 2007. The \$21 million decrease in net indebtedness is primarily due to the repayment of \$50 million under our revolving bank credit facility in the first quarter of 2008, offset by higher bank indebtedness and lower cash and cash equivalents.



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Our Credit Agreement, entered into in connection with the Transaction, consists of an \$800 million senior secured tranche B term loan facility and a \$750 million senior secured revolving credit facility. In connection with the closing of the Transaction, the Company borrowed \$800 million under the tranche B term loan facility, which has subsequently been reduced to \$641 million. The revolving credit facility may be used by the Company, Domtar Paper Company, LLC and Domtar Inc. for working capital needs and for general corporate purposes and a portion is available for letters of credit. Borrowings by the U.S. Borrowers under the revolving credit facility are available in U.S. dollars, and borrowings by Domtar Inc. under the revolving credit facility are available in U.S. dollars and/or Canadian dollars and are limited to \$150 million (or the Canadian dollar equivalent thereof).

The tranche B term loan facility matures on March 7, 2014, and the revolving credit facility matures on March 7, 2012. The tranche B term loan facility amortizes in nominal quarterly installments (equal to one percent of the aggregate initial principal amount thereof per annum) with the balance due on the maturity date.

Amounts drawn under the tranche B term loan facility bear annual interest at either a Eurodollar rate plus a margin of 1.375%, or an alternate base rate plus a margin of 0.375%. Amounts drawn under the revolving credit facility bear annual interest at either a Eurodollar rate plus a margin of between 1.25% and 2.25%, or an alternate base rate plus a margin of between 0.25% and 1.25%. Amounts drawn under the revolving credit facility by Domtar Inc. in U.S. dollars bear annual interest at either a Eurodollar rate plus a margin of between 1.25% and 2.25%, or a U.S. base rate plus a margin of between 0.25% and 1.25%. Amounts drawn under the revolving credit facility by Domtar Inc. in Canadian dollars bear annual interest at the Canadian prime rate plus a margin of between 0.25% and 1.25%. Domtar Inc. may also issue bankers' acceptances denominated in Canadian dollars which are subject to an acceptance fee, payable on the date of acceptance, which is calculated at a rate per annum equal to between 1.25% and 2.25%. The interest rate margins and the acceptance fee, in each case, with respect to the revolving credit facility, are subject to change based on the Company's consolidated leverage ratio.

The Credit Agreement contains a number of covenants that, among other things, limit the ability of the Company and its subsidiaries to make capital expenditures and place restrictions on other matters customarily restricted in senior secured credit facilities, including restrictions on indebtedness (including guarantee obligations), liens (including sale and leasebacks), fundamental changes, sales or disposition of property or assets, investments (including loans, advances, guarantees and acquisitions), transactions with affiliates, hedge agreements, dividends and other payments in respect of capital stock, changes in fiscal periods, environmental activity, optional payments and modifications of other material debt instruments, negative pledges and agreements restricting subsidiary distributions and changes in lines of business. For so long as the revolving credit commitments are outstanding, we are required to comply with a consolidated EBITDA (as defined under the Credit Agreement) to consolidated cash interest coverage ratio of greater than 2.50x and a consolidated debt to consolidated EBITDA (as defined under the Credit Agreement) ratio of less than 4.75x, decreasing to 4.5x on December 31, 2008. The Credit Agreement contains customary events of default, provided that non-compliance with the consolidated cash interest coverage ratio or consolidated leverage ratio will not constitute an event of default under the tranche B term loan facility unless it has not been waived by the revolving credit lenders within a period of 45 days after notice.

The Company's direct and indirect, existing and future, U.S. wholly-owned subsidiaries serve as guarantors of the senior secured credit facilities for any obligations thereunder of the U.S. borrowers, subject to certain agreed exceptions. The Company and its subsidiaries, serve as guarantors of Domtar Inc.'s obligations as a borrower under the senior secured credit facilities, subject to agreed exceptions. Domtar Inc. does not guarantee Domtar Corporation's obligations under the Credit Agreement.

The obligations of the Company in respect to the senior secured credit facilities are secured by all of the equity interests of the Company's direct and indirect U.S. subsidiaries and 65% of the equity interests of the Company's direct and indirect first-tier foreign subsidiaries, subject to agreed exceptions, and a perfected first priority security interest in substantially all of the Company's and its direct and indirect U.S. subsidiaries tangible and intangible assets. The obligations of Domtar Inc., and the obligations of the non-U.S. guarantors, in respect of the senior secured credit facilities are secured by all of the equity interests of the Company's direct and indirect subsidiaries, subject to agreed exceptions, and a perfected first priority security interest, lien and hypothec in the inventory of Domtar Inc., its immediate parent, and its direct and indirect subsidiaries.

As of March 30, 2008, there were no outstanding borrowings under our revolving credit facility and \$6 million of borrowings outstanding in the form of an overdraft. In addition, at March 30, 2008, we had outstanding letters of credit amounting to \$45 million under this credit facility. We also have other outstanding letters of credit amounting to \$2 million.

During March 2008, we redeemed the remaining outstanding balance of Domtar Inc.'s 10% and 10.85% Debentures for a total consideration of \$3 million. The majority of Domtar Inc.'s 10% and 10.85% Debentures was redeemed in December 2007.





**Table of Contents****Credit Rating**

<b>RATING AGENCY</b>	<b>SECURITY</b>	<b>RATING</b>
Moody's Investors Services	Secured Credit Facility	Ba1
	Unsecured debt obligations	B1
Standard & Poor's	Secured Credit Facility	BB+
	Unsecured debt obligations	B+

The ratings by Moody's Investors Services (Moody's) are the fifth and sixth best ratings in terms of quality within nine rating gradations, with the numerical modifier 1 indicating a ranking at the top end of a rating category. According to Moody's, a rating of Ba has speculative elements and a rating of B is considered speculative. The ratings by Standard & Poor's (S&P) are the fifth and sixth best ratings in terms of quality within ten rating gradations, with the plus indicating a ranking at the higher end of this category. According to S&P, ratings of BB and B have significant speculative characteristics.

Both agencies have a stable outlook in respect to these ratings. Any reductions in our credit ratings would have a negative impact on our access to and cost of capital and financial flexibility. The above ratings are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the above rating agencies.

*Domtar Canada Paper Inc. Exchangeable Shares*

Upon the consummation of the Transaction, Domtar Inc. shareholders had the option to receive either common stock of the Company or shares of Domtar (Canada) Paper Inc. that are exchangeable for common stock of the Company. As of March 30, 2008, we had 43,561,065 exchangeable shares issued and outstanding. The exchangeable shares of Domtar (Canada) Paper Inc. are intended to be substantially the economical equivalent to shares of the Company's common stock. These shareholders may exchange the exchangeable shares for shares of Domtar Corporation common stock on a one-for-one basis at any time. The exchangeable shares may be redeemed by Domtar (Canada) Paper Inc. on a redemption date to be set by the Board of Directors, which cannot be prior to July 31, 2023, or upon the occurrence of certain specified events.

**OFF BALANCE SHEET ARRANGEMENTS**

In the normal course of business, we finance certain of our activities off balance sheet through leases and securitization.

**Receivables Securitization**

We sell certain of our trade receivables through a securitization program, which expires in February 2011. We use securitization of our receivables as a source of financing by reducing our working capital requirements. This securitization program consists of the sale of receivables, or the sale of a senior beneficial interest in them, to a special purpose trust managed by a financial institution for multiple sellers of receivables. The agreement governing our receivables securitization program normally allows the daily sale of new receivables to replace those that have been collected. It also limits the cash that can be received from the sale of the senior beneficial interest to a maximum of \$150 million. The subordinated interest retained by us is included in Receivables on the consolidated balance sheet and will be collected only after the senior beneficial interest has been settled. The book value of the retained subordinated interest approximates fair value.

As of March 30, 2008, the senior beneficial interest in receivables held by third parties was \$130 million. We expect to continue selling receivables on an ongoing basis, given the attractive discount rates. Should this program be discontinued either by management's decision or due to termination of the program by the provider, our working capital and bank debt requirements will increase.

**GUARANTEES****Indemnifications**

In the normal course of business, we offer indemnifications relating to the sale of our businesses and real estate. In general, these indemnifications may relate to claims from past business operations, the failure to abide by covenants and the breach of representations and warranties included in sales agreements. Typically, such representations and warranties relate to taxation, environmental, product and employee



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matters. The terms of these indemnification agreements are generally for an unlimited period of time. At March 30, 2008, we are unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provisions have been recorded. These indemnifications have not yielded significant expenses in the past.

### **Tax Sharing Agreement**

In conjunction with the Transaction, we signed a Tax Sharing Agreement that governs both our and Weyerhaeuser's rights and obligations after the Transaction with respect to taxes for both pre and post-Distribution periods in regards to ordinary course taxes, and also covers related administrative matters. The Distribution refers to the distribution of our common stock to Weyerhaeuser shareholders.

We will generally be required to indemnify Weyerhaeuser and its shareholders against any tax resulting from the Distribution if that tax results from an act or omission by us after the Distribution. However, if Weyerhaeuser should recognize a gain on the Distribution for reasons not related to an act or omission to act by us after the Distribution, Weyerhaeuser would be responsible for such taxes and would not be entitled to indemnification by us under the Tax Sharing Agreement. In addition, to preserve the Weyerhaeuser tax-free treatment of the Distribution, the following actions will be subject to restrictions for a two-year period following the date of the Distribution:

redemption, recapitalization, repurchase or acquisition of our own capital stock;

issuance of capital stock or convertible debt;

liquidation of Domtar Corporation;

discontinuance of the operations of the Weyerhaeuser Fine Paper Business;

sale or disposition (other than in the ordinary course of business) of all or a substantial part of the Weyerhaeuser Fine Paper Business; or

other actions, omissions to act or transactions that could jeopardize the tax-free status of the Distribution.

### **Pension Plans**

We have indemnified and held harmless the trustees of our pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions from us or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. At March 30, 2008, we had not recorded a liability associated with these indemnifications, as we do not expect to make any payments pertaining to these indemnifications.

### **E.B. Eddy Acquisition**

On July 31, 1998, Domtar Inc. acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement includes a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of Domtar Inc. in specified circumstances, Domtar Inc. may have to pay up to a maximum of CDN\$120 million (approximately \$117 million), an amount which is gradually declining over a 25-year period. At March 7, 2007, the closing date of the Transaction, the maximum amount of the purchase price adjustment was CDN\$110 million (approximately \$107 million). No provision was recorded for this potential purchase price adjustment.

On March 14, 2007, we received a letter from George Weston Limited (the previous owner of E.B. Eddy and a party to the purchase agreement) demanding payment of CDN\$110 million (approximately \$107 million) as a result of the consummation of the Transaction. On June 12, 2007,

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an action was commenced by George Weston Limited against Domtar Inc. in the Superior Court of Justice of the Province of Ontario, Canada, claiming that the consummation of the Transaction triggered the purchase price adjustment and seeking a purchase price adjustment of CDN\$110 million (approximately \$107 million) as well as additional compensatory damages. We do not believe that the consummation of the Transaction triggers an obligation to pay an increase in consideration under the purchase price adjustment and intend to defend ourselves vigorously against any claims with respect thereto. However, we may not be successful in our defense of such claims, and if we are ultimately required to pay an increase in consideration, such payment may have a material adverse effect on our liquidity, results of operations and financial condition.

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**Table of Contents****RECENT ACCOUNTING PRONOUNCEMENTS****Accounting Change Implemented**

In September 2006, the FASB issued SFAS 157, Fair Value Measurements ( SFAS 157 ), which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. This statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Beginning in fiscal year 2008, we have elected to partially adopt SFAS 157 in accordance with FASB Staff Position No. FAS 157-2 ( FSP FAS 157-2 ), which delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for all nonrecurring fair value measurements of non financial assets and non financial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis including those measured at fair value in goodwill impairment testing, asset retirement obligations initially measured at fair value, exit and disposal costs initially measured at fair value, and those initially measured at fair value in a business combination.

The implementation of SFAS No. 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on our consolidated financial position and results of operations. We are currently assessing the impact of SFAS No. 157 for non-financial assets and non-financial liabilities on our consolidated financial position and results of operations.

**Future Accounting Changes***Business combinations*

In December 2007, the FASB issued Statement No. 141 (revised 2007), Business Combinations ( SFAS No. 141(R) ). This Statement replaces SFAS No. 141, Business Combinations and requires an acquirer to recognize the assets acquired, the liabilities assumed, including those arising from contingent considerations and contractual contingencies based on their fair values as measured on the acquisition date. In addition, SFAS No. 141(R) requires the acquirer to measure the noncontrolling interest in the acquiree at fair value, which will result in recognizing the goodwill attributable to the non-controlling interest in addition to the goodwill attributable to the acquirer. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Since Statement 141(R) will only be applicable to future business combinations, it will not have a significant effect on our financial position, results of operations or cash flows prior to such acquisitions.

*Noncontrolling interests*

In December 2007, the FASB issued Statement No. 160, Non-controlling Interests in Consolidated Financial Statements ( SFAS No. 160 ). SFAS No. 160 amends Accounting Research Bulletin 51, Consolidated Financial Statements, to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. This Statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS No. 160 changes the way the consolidated earnings (loss) statement is presented by requiring consolidated net earnings (loss) to be reported including the amounts attributable to both the parent interest and the noncontrolling interest. The Statement requires disclosure on the face of the consolidated statement of operations of the amounts of consolidated net earnings (loss) attributable to the parent interest and to the noncontrolling interest. SFAS No. 160 is effective for fiscal periods, and interim periods within those fiscal years, beginning on or after December 15, 2008.

We do not expect the initial adoption of SFAS 160 to have a significant effect on our financial position, results of operations and cash flows as we have no significant noncontrolling interests.

*Derivative instruments and hedging activities*

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 ( SFAS No. 161 ). SFAS No. 161 expands quarterly disclosure requirements in SFAS No. 133 about an entity's derivative instruments and hedging activities. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. We are currently assessing the impact of SFAS No. 161 on our future disclosures.

**CRITICAL ACCOUNTING POLICIES**

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The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect our results of operations and financial position. On an ongoing basis, management reviews its estimates, including those related to environmental matters and other asset retirement obligations, useful lives, impairment of long-lived assets, goodwill, pension plans and other post-retirement benefit plans and income taxes based on currently available information. Actual results could differ from those estimates.

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Critical accounting policies reflect matters that contain a significant level of management estimates about future events, reflect the most complex and subjective judgments, and are subject to a fair degree of measurement uncertainty.

We have included in our Annual Report on Form 10-K for the year ended December 30, 2007, a discussion of these critical accounting policies, which are important to the understanding of our financial condition and results of operations and require management's judgments. We did not make any changes in any of these critical accounting policies during the first quarter of 2008.

## **FORWARD-LOOKING STATEMENTS**

The information included in this Quarterly Report on Form 10-Q may contain forward-looking statements relating to trends in, or representing management's beliefs about, our future growth, results of operations, performance and business prospects and opportunities. These forward-looking statements are generally denoted by the use of words such as anticipate, believe, expect, intend, aim, target, plan, estimate, project, may, will, should and similar expressions. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to known and unknown risks and uncertainties and other factors that could cause actual results to differ materially from historical results or those anticipated. Accordingly, no assurances can be given that any of the events anticipated by the forward-looking statements will occur, or if any occurs, what effect they will have on our result of operations or financial condition. These factors include, but are not limited to:

the effect of general economic conditions, particularly in the U.S. and Canada;

market demand for our products, which may be tied to the relative strength of various U.S. and/or Canadian business segments;

product selling prices;

raw material prices, including wood fiber, energy and chemical;

performance of our manufacturing operations, including unexpected maintenance requirements;

the successful integration of the Weyerhaeuser Fine Paper Business with Domtar Inc. and the ability to realize anticipated cost savings;

the level of competition from domestic and foreign producers;

the effect of forestry, land use, environmental and other governmental regulations, and changes in accounting regulations;

the effect of weather and the risk of loss from fires, floods, windstorms, hurricanes and other natural disasters;

transportation costs;



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the loss of current customers or the inability to obtain new customers;

legal proceedings;

changes in asset valuations, including write downs of property, plant and equipment, inventory, accounts receivable or other assets for impairment or other reasons;

changes in currency exchange rates, particularly the relative value of the U.S. dollar to the Canadian dollar;

the effect of timing of retirements and changes in the market price of our common stock on charges for stock-based compensation;

performance of pension fund investments and related derivatives; and

the other factors described under Risk Factors, in item 1A of our Annual Report on Form 10-K, for the year ended December 30, 2007.

You are cautioned not to unduly rely on such forward-looking statements, which speak only as of the date made, when evaluating the information presented in this Quarterly Report on Form 10-Q. Unless specifically required by law, we assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances.

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

Information relating to quantitative and qualitative disclosure about market risk is contained in our Annual Report on Form 10-K for the year ended December 30, 2007. There has not been any material change in our exposure to market risk since March 30, 2008, except for the following.

**FOREIGN CURRENCY RISK**

We have manufacturing operations in the United States and Canada. As a result, we are exposed to movements in the foreign currency exchange rate in Canada. Approximately 19% of our uncoated freesheet paper production capacity and 55% of our trade pulp production capacity as well as our Wood business are in Canada, with manufacturing costs primarily denominated in Canadian dollars. Also, certain assets and liabilities are denominated in Canadian dollars and are exposed to foreign currency movements. As a result, our earnings are affected by an increase or decrease in the value of the Canadian dollar relative to the U.S. dollar. See Item 1A, Risk Factors. The Company is affected by changes in currency exchange rate in our Annual Report on Form 10-K for the year ended December 30, 2007.

**Derivative Instruments and hedging activities**

We use derivative instruments (currency options and forward foreign exchange contracts) to mitigate our exposure to fluctuations in foreign currency exchange rates. Forward foreign exchange contracts are contracts whereby we have the obligation to buy Canadian dollars at a specific rate. Currency options purchased are contracts whereby we have the right, but not the obligation, to buy Canadian dollars at the strike rate if the Canadian dollar trades above that rate. Currency options sold are contracts whereby we have the obligation to buy Canadian dollars at the strike rate if the Canadian dollar trades below that rate. Our policy is to hedge a significant portion of forecasted purchases in Canadian dollars. We do not enter into derivative financial instruments for trading or speculative purposes. The derivative financial instruments are recorded on the Consolidated Balance Sheets at fair value derived from quoted market rates and are included in prepaid expenses and trade and other payables. These contracts are entered into with large, reputable financial institutions, which are monitored for counterparty risk. The forward foreign exchange contracts are valued using the interest rate parity principle and broker quotations taken on Reuters 3000. The currency options contracts are valued using the Garman Kohlhagen Model and broker quotations taken on Reuters 3000. The quotations used in both models were based on the rates in effect at March 30, 2008.

In 2008, we formally document the relationships between hedging instruments and hedged items, as well as our risk management objectives and strategies for undertaking the hedge transactions. Forward foreign exchange contracts and currency options contracts used to hedge forecasted purchases in Canadian dollars are designated as cash flow hedges. These contracts are used to hedge forecasted purchases over approximately 12 to 18 months. Changes in the fair value of derivatives contracts designated as cash flow hedges are recorded as a component of accumulated other comprehensive income within shareholders' equity, and are recognized in cost of sales in the period in which the hedged transaction occurs.

During the first quarter of 2008, we recorded an after tax loss of \$5 million in accumulated other comprehensive income related to cash flow hedges, which will be recognized in cost of sales upon the maturity of the derivatives during the fifty-two weeks period ending March 29, 2009 at the then current values, which may be different from the March 30, 2008 values. At March 30, 2008, the fair value of these contracts was \$8 million in prepaid expenses and \$8 million in trade and other payables on the Consolidated Balance sheets. The critical terms of the hedging instruments (currency options and forward foreign exchange contracts) and the hedged items match. As a result, there were no material amounts reflected in the first quarter of 2008 resulting from hedge ineffectiveness.

During the first quarter of 2008, the gain recorded in cost of sales in the consolidated statement of earnings related to the change in the fair value of forward foreign exchange contracts designated as cash flow hedges that matured during the period and was not material.

In 2007, we had derivative instruments that were recorded at fair value in the purchase price allocation. As such, hedge accounting was not permitted and these instruments were recorded at fair value with the resulting gains and losses being reflected in earnings. For the first quarter of 2007, we recorded nil in earnings. At December 30, 2007, we had no derivative instruments outstanding.

**ITEM 4. CONTROLS AND PROCEDURES***Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities and Exchange Act of 1934, as amended ( Exchange Act ), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief



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Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure within the time periods specified in the Securities and Exchange Commissions rules and forms. As of the end of the period covered by this report, an evaluation was performed by members of management, at the direction and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 30, 2008, our disclosure controls and procedures were effective at a reasonable assurance level.

### *Change in Internal Controls over Financial Reporting*

There were no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting during the period covered by this report.

We do have ongoing initiatives to standardize and upgrade certain of our financial and operating systems. The system upgrades will be implemented in stages over the next several years. Management believes the necessary procedures are in place to maintain effective internal control over financial reporting as these initiatives continue.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

A discussion of material developments in the Company's litigation and settlement matters occurring in the period covered by this report is found in Note 13 to the financial statements in this Quarterly Report on Form 10-Q.

### **ITEM 1A. RISK FACTORS**

Our Annual Report on Form 10-K for the year ended December 30, 2007, contains important risk factors that could cause our actual results to differ materially from those projected in any forward-looking statement. There are no significant changes to the risk factors described in our Annual Report on Form 10-K.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

### **ITEM 3. DEFAULT UPON SENIOR SECURITIES**

Not applicable.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

### **ITEM 5. OTHER INFORMATION**

Not applicable.



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**ITEM 6. EXHIBITS**

Exhibit 12.1	Computation of Ratio of Earnings to Fixed Charges
Exhibit 31.1	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

**DOMTAR CORPORATION**

Date: May 9, 2008

By: /s/ RAZVAN THEODORU  
Razvan Theodoru  
Vice-President and Secretary