
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2011

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)

DELAWARE
(State of Incorporation)

20-5901152
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation ST (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

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 2, 2011, 41,032,193 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 31, 2011
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

DOMTAR CORPORATION
CONSOLIDATED STATEMENTS OF EARNINGS
For the three months ended March 31, 2011 and March 31, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

| | March 31, 2011 | March 31, 2010 |
|--|-------------------|-------------------|
| | (Unaudited) | |
| | \$ | \$ |
| Sales | 1,423 | 1,457 |
| Operating expenses | | |
| Cost of sales, excluding depreciation and amortization | 1,021 | 1,142 |
| Depreciation and amortization | 93 | 102 |
| Selling, general and administrative | 90 | 84 |
| Impairment and write-down of property, plant and equipment (NOTE 8) | 3 | 22 |
| Closure and restructuring costs (NOTE 8) | 11 | 20 |
| Other operating income, net | (6) | (29) |
| | <u>1,212</u> | <u>1,341</u> |
| Operating income | 211 | 116 |
| Interest expense, net | 21 | 32 |
| Earnings before income taxes | 190 | 84 |
| Income tax expense | 57 | 26 |
| Net earnings | <u>133</u> | <u>58</u> |
| Per common share (in dollars) (NOTE 4) | | |
| Net earnings | | |
| Basic | 3.16 | 1.35 |
| Diluted | 3.14 | 1.34 |
| Weighted average number of common and exchangeable shares outstanding (millions) | | |
| Basic | 42.1 | 43.0 |
| Diluted | 42.4 | 43.3 |

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

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DOMTAR CORPORATION
CONSOLIDATED BALANCE SHEETS

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

| | At | |
|---|-------------------|----------------------|
| | March 31, 2011 | December 31, 2010 |
| | (Unaudited) | |
| | \$ | \$ |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 604 | 530 |
| Receivables, less allowances of \$5 and \$7 | 721 | 601 |
| Inventories (NOTE 6) | 643 | 648 |
| Prepaid expenses | 32 | 28 |
| Income and other taxes receivable | 54 | 78 |
| Deferred income taxes | 116 | 115 |
| Total current assets | 2,170 | 2,000 |
| Property, plant and equipment, at cost | 9,336 | 9,255 |
| Accumulated depreciation | (5,625) | (5,488) |
| Net property, plant and equipment | 3,711 | 3,767 |
| Intangible assets, net of amortization (NOTE 7) | 57 | 56 |
| Other assets | 203 | 203 |
| Total assets | 6,141 | 6,026 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Bank indebtedness | 25 | 23 |
| Trade and other payables | 661 | 678 |
| Income and other taxes payable | 21 | 22 |
| Long-term debt due within one year | 2 | 2 |
| Total current liabilities | 709 | 725 |
| Long-term debt | 825 | 825 |
| Deferred income taxes and other | 955 | 924 |
| Other liabilities and deferred credits | 364 | 350 |
| Commitments and contingencies (NOTE 11) | | |
| Shareholders' equity | | |
| Common stock | | |
| \$.01 par value; authorized 2,000,000,000 shares; issued: 42,375,757 and 42,300,031 shares | — | — |
| Treasury stock (NOTE 10) | | |
| \$.01 par value; 1,379,611 and 664,857 shares | — | — |
| Exchangeable shares | | |
| No par value; unlimited shares authorized; issued and held by nonaffiliates: 740,674 and 812,694 shares | 58 | 64 |
| Additional paid-in capital | 2,732 | 2,791 |
| Retained earnings | 480 | 357 |
| Accumulated other comprehensive income (loss) | 18 | (10) |
| Total shareholders' equity | 3,288 | 3,202 |
| Total liabilities and shareholders' equity | 6,141 | 6,026 |

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

DOMTAR CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

| | Issued and outstanding common and exchangeable shares (millions of shares) | Exchangeable shares | Additional paid-in capital (Unaudited) | Retained earnings | Accumulated other comprehensive income (loss) | Total shareholders' equity |
|---|--|------------------------|--|----------------------|---|----------------------------------|
| | | \$ | \$ | \$ | \$ | \$ |
| Balance at December 31, 2010 | 42.4 | 64 | 2,791 | 357 | (10) | 3,202 |
| Conversion of exchangeable shares | — | (6) | 6 | — | — | — |
| Stock based compensation | — | — | 4 | — | — | 4 |
| Net earnings | — | — | — | 133 | — | 133 |
| Net derivative losses on cash flow hedges: | | | | | | |
| Net gain arising during the period, net of tax of \$1 | — | — | — | — | 4 | 4 |
| Foreign currency translation adjustments | — | — | — | — | 24 | 24 |
| Stock repurchase | (0.7) | — | (69) | — | — | (69) |
| Cash dividends | — | — | — | (10) | — | (10) |
| Balance at March 31, 2011 | <u>41.7</u> | <u>58</u> | <u>2,732</u> | <u>480</u> | <u>18</u> | <u>3,288</u> |

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

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DOMTAR CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended March 31, 2011 and March 31, 2010

(IN MILLIONS OF DOLLARS)

| | March 31, 2011 | March 31, 2010 |
|---|-------------------|-------------------|
| | (Unaudited) | |
| | \$ | \$ |
| Operating activities | | |
| Net earnings | 133 | 58 |
| Adjustments to reconcile net earnings to cash flows from operating activities | | |
| Depreciation and amortization | 93 | 102 |
| Deferred income taxes and tax uncertainties | 29 | 15 |
| Impairment and write-down of property, plant and equipment | 3 | 22 |
| Net gains on disposals of property, plant and equipment and sale of business | (7) | (1) |
| Stock-based compensation expense | 1 | 1 |
| Other | 1 | (1) |
| Changes in assets and liabilities | | |
| Receivables | (111) | (90) |
| Inventories | 1 | 10 |
| Prepaid expenses | (1) | (5) |
| Trade and other payables | (29) | (25) |
| Income and other taxes | 23 | 23 |
| Difference between employer pension and other post-retirement contributions and pension and other post-retirement expense | 2 | 10 |
| Other assets and other liabilities | 10 | 4 |
| Cash flows provided from operating activities | <u>148</u> | <u>123</u> |
| Investing activities | | |
| Additions to property, plant and equipment | (13) | (31) |
| Proceeds from disposals of property, plant and equipment | 9 | 7 |
| Proceeds from sale of business | 4 | — |
| Cash flows used for investing activities | <u>—</u> | <u>(24)</u> |
| Financing activities | | |
| Dividend payments | (11) | — |
| Net change in bank indebtedness | 3 | (23) |
| Repayment of long-term debt | (1) | (103) |
| Borrowings under accounts receivable securitization program | — | 20 |
| Stock repurchase | (69) | — |
| Other | 4 | (3) |
| Cash flows used for financing activities | <u>(74)</u> | <u>(109)</u> |
| Net increase (decrease) in cash and cash equivalents | 74 | (10) |
| Cash and cash equivalents at beginning of period | <u>530</u> | <u>324</u> |
| Cash and cash equivalents at end of period | <u>604</u> | <u>314</u> |
| Supplemental cash flow information | | |
| Net cash payments for: | | |
| Interest | 14 | 21 |
| Income taxes paid (refund) | <u>2</u> | <u>(1)</u> |

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

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DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(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 statement of Domtar Corporation's ("the Company") financial position, results of operations, and cash flows for the interim periods presented. Except as disclosed in the Notes to Consolidated Financial Statements, such adjustments are of a normal, recurring nature. Results for the first three months 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 the Domtar Corporation Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as filed with the Securities and Exchange Commission. The December 31, 2010 Consolidated Balance Sheet, presented for comparative purposes in this interim report, was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

ACCOUNTING CHANGES IMPLEMENTED

STOCK COMPENSATION

In April 2010, the FASB issued an update to Compensation – Stock Compensation, which addresses the classification of an employee share-based payment award with an exercise price denominated in the currency of a market in which the underlying security trades. This update clarifies that those employee share-based payment awards should not be considered to contain a condition that is not a market, performance, or service condition and therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity.

This update is effective for fiscal years and interim periods beginning on or after December 15, 2010 with early adoption permitted. The Company adopted the new requirement on January 1, 2011 with no impact on the Company's consolidated financial statements.

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT

INTEREST RATE RISK

The Company is exposed to interest rate risk arising from fluctuations in interest rates on its cash and cash equivalents, its bank indebtedness, its bank credit facility and its long-term debt. The Company may manage this interest rate exposure through the use of derivative instruments such as interest rate swap contracts.

CREDIT RISK

The Company is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, the Company reviews new customers' credit history before granting credit and conducts regular reviews of existing customers' credit performance. As at March 31, 2011 and December 31, 2010, the Company did not have any customers that represented more than 10% of the receivables.

The Company is also exposed to credit risk in the event of non-performance by counterparties to its financial instruments. The Company minimizes this exposure by entering into contracts with counterparties that are believed to be of high credit quality. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. The credit standing of counterparties is regularly monitored. Additionally, the Company is exposed to credit risk in the event of non-performance by its insurers. The Company minimizes this exposure by doing business only with large reputable insurance companies.

COST RISK

Cash flow hedges:

The Company purchases natural gas and oil at the prevailing market price at the time of delivery. In order to manage the cash flow risk associated with purchases of natural gas and oil, the Company may utilize derivative financial instruments or physical purchases to fix the price of forecasted natural gas and oil purchases. The Company formally documents the hedge relationships, including identification of the hedging instruments and the hedged items, the risk management objectives and strategies for undertaking the hedge transactions, and the methodologies used to assess effectiveness and measure ineffectiveness. Current contracts are used to hedge forecasted purchases over the next three years. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded as a component of Accumulated other comprehensive income (loss) within Shareholders' equity, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

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DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents the volumes under derivative financial instruments for natural gas contracts outstanding as of March 31, 2011 to hedge forecasted purchases:

| Commodity | Notional contractual quantity under derivative contracts | | Notional contractual value under derivative contracts | Percentage of forecasted purchases under derivative contracts for | | |
|-------------|---|----------------------|--|---|------|------|
| | | | | 2011 | 2012 | 2013 |
| Natural gas | 6,105,000 | MMBTU ⁽¹⁾ | \$ 35 | 31% | 12% | 5% |

(1) MMBTU: Millions of British thermal units

The natural gas derivative contracts were fully effective for accounting purposes as of March 31, 2011. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the three months ended March 31, 2011 resulting from hedge ineffectiveness (2010 – nil).

FOREIGN CURRENCY RISK

Cash flow hedges:

The Company has manufacturing operations in the United States and Canada. As a result, it is exposed to movements in the foreign currency exchange rate in Canada. Also, certain assets and liabilities are denominated in Canadian dollars and are exposed to foreign currency movements. As a result, the Company's earnings are affected by increases or decreases in the value of the Canadian dollar relative to the U.S. dollar. The Company's risk management policy allows it to hedge a significant portion of its exposure to fluctuations in foreign currency exchange rates for periods up to three years. The Company may use derivative instruments (currency options and foreign exchange forward contracts) to mitigate its exposure to fluctuations in foreign currency exchange rates. Foreign exchange forward contracts are contracts whereby the Company has the obligation to buy Canadian dollars at a specific rate. Currency options purchased are contracts whereby the Company has 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 the Company has the obligation to buy Canadian dollars at the strike rate if the Canadian dollar trades below that rate.

The Company formally documents the relationship 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. Current contracts are used to hedge forecasted purchases over the next 12 months. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded as a component of Accumulated other comprehensive income (loss) within Shareholders' equity, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents the currency values under contracts pursuant to currency options outstanding as of March 31, 2011 to hedge forecasted purchases:

| <u>Contract</u> | | <u>Notional contractual value</u> | <u>Percentage of CDN denominated forecasted expenses, net of revenues under contracts for</u> | |
|----------------------------|--------|-----------------------------------|---|-------------|
| | | | <u>2011</u> | <u>2012</u> |
| Currency options purchased | CDN \$ | 400 | 50% | 13% |
| Currency options sold | CDN \$ | 400 | 50% | 13% |

The currency options are fully effective as at March 31, 2011. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the three months ended March 31, 2011 resulting from hedge ineffectiveness (2010 – nil).

The Effect of Derivative Instruments on the Consolidated Statements of Earnings and Consolidated Statement of Shareholders' Equity

| <u>Derivatives Designated as Cash Flow Hedging Instruments under the Derivatives and Hedging Topic of FASB ASC</u> | <u>Gain (Loss) Recognized in Accumulated Other Comprehensive Income (Loss) on Derivatives (Effective Portion)</u> | | <u>Gain (Loss) Reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion)</u> | |
|--|---|-----------------------|--|-----------------------|
| | <u>For the three months ended</u> | | <u>For the three months ended</u> | |
| | <u>March 31, 2011</u> | <u>March 31, 2010</u> | <u>March 31, 2011</u> | <u>March 31, 2010</u> |
| | \$ | \$ | \$ | \$ |
| Natural gas swap contracts (a) | — | (5) | (2) | (1) |
| Currency options (a) | 4 | 4 | 2 | 10 |
| Total | 4 | (1) | — | 9 |

(a) The Gain (Loss) reclassified from Accumulated Other Comprehensive Income (Loss) into Income (Effective Portion) is recorded in Cost of sales.

The gain (loss) recorded in Accumulated other comprehensive income (loss) relating to natural gas contracts will be recognized in Cost of sales upon maturity of the derivatives over the next three years at the then prevailing values, which may be different from those at March 31, 2011.

The gain (loss) recorded in Accumulated other comprehensive income (loss) relating to currency options will be recognized in Cost of sales upon maturity of the derivatives over the next 12 months at the then prevailing values, which may be different from those at March 31, 2011.

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)

The accounting standards dealing with fair value measurement and disclosures, establishes a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three levels. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is available and significant to the fair value measurement. The accounting standards dealing with fair value measurement and disclosures establishes and prioritizes three levels of inputs that may be used to measure fair value:

| | |
|---------|---|
| Level 1 | Quoted prices in active markets for identical assets or liabilities. |
| Level 2 | Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. |
| Level 3 | Inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. |

The following tables present information about the Company's financial assets and financial liabilities measured at fair value on a recurring basis (except Long-term debt, see (c) below) at March 31, 2011 and December 31, 2010, in accordance with the accounting standards dealing with fair value measurement and disclosures and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

Fair Value of financial instruments at:

| Derivatives designated as cash flow hedging instruments under the Derivatives and Hedging Topic of FASB ASC: | March 31, 2011 | Quoted prices in active markets for identical assets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Balance sheet classification |
|--|-------------------|---|--|--|--|
| | \$ | \$ | \$ | \$ | |
| Asset derivatives | | | | | |
| Currency options | 16 | — | 16 | — | (a) Prepaid expenses |
| Total Assets | 16 | — | 16 | — | |
| Liabilities derivatives | | | | | |
| Currency options | 2 | — | 2 | — | (a) Trade and other payables |
| Natural gas swap contracts | 5 | — | 5 | — | (a) Trade and other payables |
| Natural gas swap contracts | 1 | — | 1 | — | (a) Other liabilities and deferred credits |
| Total Liabilities | 8 | — | 8 | — | |
| Other Instruments: | | | | | |
| Asset backed commercial paper investments | 6 | — | — | 6 | (b) Other assets |
| Long-term debt | 978 | 978 | — | — | (c) Long-term debt |

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)

Fair Value of financial instruments at:

| Derivatives designated as cash flow hedging instruments under the Derivatives and Hedging Topic of FASB ASC: | December 31, 2010 | Quoted prices in active markets for identical assets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | Balance sheet classification |
|--|----------------------|---|--|--|--|
| | \$ | \$ | \$ | \$ | |
| Asset derivatives | | | | | |
| Currency options | 14 | — | 14 | — | (a) Prepaid expenses |
| Total Assets | 14 | — | 14 | — | |
| Liabilities derivatives | | | | | |
| Currency options | 3 | — | 3 | — | (a) Trade and other payables |
| Natural gas swap contracts | 7 | — | 7 | — | (a) Trade and other payables |
| Natural gas swap contracts | 2 | — | 2 | — | (a) Other liabilities and deferred credits |
| Total Liabilities | 12 | — | 12 | — | |
| Other Instruments: | | | | | |
| Asset backed commercial paper investments | 6 | — | — | 6 | (a) Other assets |
| Long-term debt | 979 | 979 | — | — | (c) Long-term debt |

- (a) Fair value of the Company's derivatives is classified under Level 2 (inputs that are observable; directly or indirectly) as it is measured as follows:
- For currency options: Fair value is measured using techniques derived from the Black-Scholes pricing model. Interest rates, forward market rates and volatility are used as inputs for such valuation techniques.
 - For natural gas contracts: Fair value is measured using the discounted difference between contractual rates and quoted market future rates.
- (b) Fair value of ABCP investments is classified under Level 3 and is mainly based on a financial model incorporating uncertainties regarding return, credit spreads, the nature and credit risk of underlying assets, the amounts and timing of cash inflows and the limited market for the new notes at March 31, 2011 and December 31, 2010.
- (c) Fair value of the Company's long-term debt is measured by comparison to market prices of its debt. In accordance with US GAAP, the Company's long-term debt is not carried at fair value on the Consolidated Balance Sheets at March 31, 2011 and December 31, 2010. However, fair value disclosure is required.

Due to their short-term maturity, the carrying amounts of cash and cash equivalents, receivables, bank indebtedness, trade and other payables and income and other taxes approximate their fair values.

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DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 4. EARNINGS PER SHARE

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

| | <u>For the three months ended</u> | |
|--|-----------------------------------|---------------------------------|
| | <u>March 31,</u> <u>2011</u> | <u>March 31,</u> <u>2010</u> |
| Net earnings | <u>\$ 133</u> | <u>\$ 58</u> |
| Weighted average number of common and exchangeable shares outstanding (millions) | <u>42.1</u> | <u>43.0</u> |
| Effect of dilutive securities (millions) | <u>0.3</u> | <u>0.3</u> |
| Weighted average number of diluted common and exchangeable shares outstanding (millions) | <u>42.4</u> | <u>43.3</u> |
| Basic net earnings per share (in dollars) | <u>\$ 3.16</u> | <u>\$ 1.35</u> |
| Diluted net earnings per share (in dollars) | <u>3.14</u> | <u>1.34</u> |

The following table provides the securities that could potentially dilute basic earnings per share in the future, but were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive:

| | <u>March 31,</u> <u>2011</u> | <u>March 31,</u> <u>2010</u> |
|---------|---------------------------------|---------------------------------|
| Options | <u>167,438</u> | <u>368,627</u> |

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 5. 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 three months ended March 31, 2011, the related pension expense was \$8 million (2010—\$9 million).

DEFINED BENEFIT PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS

The Company has several defined benefit pension plans covering a majority of all employees. Non-unionized employees in Canada joining the Company after June 1, 2000 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 U.S. employees; the plans are unfunded and include life insurance programs, medical and dental benefits and short-term and long-term disability programs. The Company also provides supplemental unfunded benefit plans to certain senior management employees.

Components of net periodic benefit cost for pension plans and other post-retirement benefit plans

| | For the three months ended | | | |
|--|----------------------------|---|------------------|---|
| | March 31, 2011 | | March 31, 2010 | |
| | Pension Plans | Other post-retirement benefit plans | Pension Plans | Other post-retirement benefit plans |
| | \$ | \$ | \$ | \$ |
| Service cost | 9 | 1 | 9 | 2 |
| Interest expense | 22 | 1 | 22 | 2 |
| Expected return on plan assets | (26) | — | (23) | — |
| Amortization of net actuarial loss | 3 | — | 1 | — |
| Amortization of prior year service costs | 1 | — | 1 | — |
| Net periodic benefit cost | <u>9</u> | <u>2</u> | <u>10</u> | <u>4</u> |

The Company contributed \$7 million for the three months ended March 31, 2011 (2010 – \$4 million) to the pension plans and \$2 million to the other post-retirement benefit plans (2010 – nil).

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NOTE 6. INVENTORIES

The following table presents the components of inventories:

| | <u>March 31,</u> <u>2011</u> | <u>December 31,</u> <u>2010</u> |
|------------------------------------|---------------------------------|------------------------------------|
| | \$ | \$ |
| Work in process and finished goods | 356 | 361 |
| Raw materials | 104 | 105 |
| Operating and maintenance supplies | 183 | 182 |
| | <u>643</u> | <u>648</u> |

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NOTE 7. INTANGIBLE ASSETS

The following table presents the components of intangible assets:

| | <u>Weighted average useful lives</u> | <u>March 31, 2011</u> | <u>December 31, 2010</u> |
|--|--|---------------------------|------------------------------|
| | | \$ | \$ |
| Intangible assets subject to amortization | | | |
| Water rights | 40 | 8 | 8 |
| Power purchase agreements | 25 | 34 | 33 |
| Customer relationships | 17 | 11 | 11 |
| Trade names | 7 | 7 | 7 |
| Supplier agreements | 5 | 7 | 6 |
| | | <u>67</u> | <u>65</u> |
| Allowance for amortization | | <u>(10)</u> | <u>(9)</u> |
| Total intangible assets | | <u><u>57</u></u> | <u><u>56</u></u> |

Amortization expense related to intangible assets for the three months ended March 31, 2011 was \$1 million (2010 – \$1 million).

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

| | <u>2011</u> | <u>2012</u> | <u>2013</u> | <u>2014</u> | <u>2015</u> |
|---|-------------|-------------|-------------|-------------|-------------|
| | \$ | \$ | \$ | \$ | \$ |
| Amortization expense related to intangible assets | <u>5</u> | <u>5</u> | <u>3</u> | <u>3</u> | <u>2</u> |

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NOTE 8. CLOSURE AND RESTRUCTURING LIABILITY

The Company regularly reviews its overall production capacity with the objective of adjusting its production capacity with anticipated long-term demand.

On March 29, 2011, the Company announced that it will permanently shut down one of four paper machines at its Ashdown, Arkansas pulp and paper mill. This measure will reduce the Company's annual uncoated freesheet paper production capacity by approximately 125,000 short tons. The mill's workforce will be reduced by approximately 110 employees. The Company recorded \$2 million of inventory obsolescence and \$2 million of severance and termination costs, as well as \$3 million of accelerated depreciation. Operations will cease by July 1, 2011.

On February 1, 2011, the Company announced the closure of its forms plant in Langhorne, Pennsylvania, and recorded \$4 million severance and termination costs.

During the first quarter of 2011, the Company also incurred other costs related to previous closures which include \$1 million of severance and termination costs and \$2 million of other costs.

On March 16, 2010, the Company announced that it would permanently close its coated groundwood paper mill in Columbus, Mississippi. This measure resulted in the permanent curtailment of 238,000 tons of coated groundwood and 70,000 metric tons of thermo-mechanical pulp, as well as affected 219 employees. The Company recorded a \$9 million write-down for the related fixed assets, \$8 million of severance and termination costs, and \$7 million of inventory obsolescence and \$1 million of other costs. Operations ceased in April 2010.

During the first quarter of 2010, the Company recorded \$13 million of accelerated depreciation related to the reconfiguration of the Plymouth, North Carolina mill to 100% fluff pulp production, announced on October 20, 2009. Other costs related to previous closures also include \$1 million in severance and termination costs and \$3 million of other costs.

The following tables provide the components of closure and restructuring costs by segment:

| | <u>Papers</u> | <u>Total</u> |
|--|--|------------------|
| | Three months ended March 31, 2011 | |
| | \$ | \$ |
| Severance and termination costs | 7 | 7 |
| Inventory obsolescence ⁽¹⁾ | 2 | 2 |
| Other | 2 | 2 |
| Closure and restructuring costs | <u>11</u> | <u>11</u> |

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NOTE 8. CLOSURE AND RESTRUCTURING LIABILITY (CONTINUED)

| | <u>Papers</u> | <u>Total</u> |
|--|-----------------------------------|--------------|
| | Three months ended March 31, 2010 | |
| | \$ | \$ |
| Severance and termination costs | 9 | 9 |
| Inventory obsolescence (1) | 7 | 7 |
| Other | 4 | 4 |
| Closure and restructuring costs | <u>20</u> | <u>20</u> |

- (1) Inventory obsolescence primarily relates to the write-down of operating and maintenance supplies classified as Inventories on the Consolidated Balance Sheets.

The following table provides the activity in the closure and restructuring liability:

| | <u>March 31,</u> <u>2011</u> | <u>December 31,</u> <u>2010</u> |
|---|---------------------------------|------------------------------------|
| | \$ | \$ |
| Balance at beginning of period | 17 | 24 |
| Additions | 7 | 13 |
| Severance payments | (3) | (18) |
| Change in estimates | — | (2) |
| Other | — | (1) |
| Effect of foreign currency exchange rate change | — | 1 |
| Balance at end of period | <u>21</u> | <u>17</u> |

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NOTE 9. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | <u>Three months ended</u> | |
|---|---------------------------------|---------------------------------|
| | <u>March 31,</u> <u>2011</u> | <u>March 31,</u> <u>2010</u> |
| | \$ | \$ |
| Net earnings | 133 | 58 |
| Other comprehensive income (loss) | | |
| Net derivative gains (losses) on cash flow hedges: | | |
| Net gain (loss) arising during the period, net of tax of \$1 (2010 - \$(3)) | 4 | (1) |
| Less: Reclassification adjustment for losses included in net earnings, net of tax of \$1 (2010 - \$1) | — | (9) |
| Foreign currency translation adjustments | 24 | 39 |
| Comprehensive income | 161 | 87 |

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NOTE 10. SHAREHOLDERS' EQUITY

On February 23, 2011, the Company's Board of Directors approved a quarterly dividend of \$0.25 per share to be paid to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc., a subsidiary of Domtar Corporation. The total dividends of approximately \$10 million were paid on April 15, 2011 to shareholders of record on March 15, 2011.

On May 3, 2011, the Company's Board of Directors approved a quarterly dividend of \$0.35 per share to be paid to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc., on July 15, 2011 to shareholders of record on June 15, 2011.

STOCK REPURCHASE PROGRAM

On May 4, 2010, the Company's Board of Directors authorized a stock repurchase program ("the Program") of up to \$150 million of Domtar Corporation's common stock. Under the Program, the Company is authorized to repurchase from time to time shares of its outstanding common stock on the open market or in privately negotiated transactions in the United States. The timing and amount of stock repurchases will depend on a variety of factors, including the market conditions as well as corporate and regulatory considerations. The Program may be suspended, modified or discontinued at any time and the Company has no obligation to repurchase any amount of its common stock under the Program. The Program has no set expiration date. The Company repurchases its common stock, from time to time, in part to reduce the dilutive effects of its stock options, awards, and employee stock purchase plan and to improve shareholders' returns.

During 2010 and the first quarter of 2011, the Company made open market purchases of its common stock using general corporate funds. Additionally, the Company entered into structured stock repurchase agreements with large financial institutions using general corporate funds in order to lower the average cost to acquire shares. The agreements required the Company to make up-front payments to the counterparty financial institutions which resulted in either the receipt of stock at the beginning of the term of the agreements followed by a share adjustment at the maturity of the agreements, or the receipt of either stock or cash at the maturity of the agreements, depending upon the price of the stock.

During 2010, the Company repurchased 738,047 shares at an average price of \$59.96 for a total cost of \$44 million. Also, the Company entered into structured stock repurchase agreements that did not result in the repurchase of shares but resulted in net gains of \$2 million which are recorded as a component of Shareholders' equity.

During the first quarter of 2011, the Company repurchased 789,957 shares at an average price of \$87.79 for a total cost of \$69 million. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

On May 3, 2011, the Company's Board of Directors approved an increase to the Program from \$150 million to \$600 million.

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NOTE 11. 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 pulp and paper mill in Prince Albert, Saskatchewan was closed due to poor market conditions. The Company's management determined that the Prince Albert facility was no longer a strategic fit for the Company and will not be reopened. The Province of Saskatchewan may require active decommissioning and reclamation at the Prince Albert facility. In the event decommissioning and reclamation is required at the facility, the work is likely to include investigation and remedial action for areas of significant environmental impacts. On May 3, 2011, Domtar sold its Prince Albert facility to Paper Excellence Canada Holdings Corporation ("Paper Excellence"). Paper Excellence agreed to assume all past, present and future known and unknown environmental liabilities and as such, Domtar will reverse its reserve for environmental liabilities for this site in the second quarter of 2011 (See Note 14 "Subsequent Event").

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 and heavy metal. On February 16, 2010, the government of British Columbia issued a Remediation Order to Seaspan and Domtar in order to define and implement an action plan to address soil, sediment and groundwater issues. This Order was appealed to the Environmental Appeal Board ("Board") on March 17, 2010 but there is no suspension in the execution of this Order unless the Board orders otherwise. The hearing scheduled for January 2011 was cancelled and no alternative date was scheduled as of yet. The relevant government authorities are reviewing several remediation plans and a decision is expected in 2011. The Company has recorded an environmental reserve to address estimated exposure.

The following table reflects changes in the reserve for environmental remediation and asset retirement obligations:

| | <u>March 31,</u> <u>2011</u> | <u>December 31,</u> <u>2010</u> |
|---|---------------------------------|------------------------------------|
| | \$ | \$ |
| Balance at beginning of period | 107 | 111 |
| Additions | — | 4 |
| Sale of businesses | — | (9) |
| Environmental spending | (2) | (7) |
| Accretion | 1 | 4 |
| Effect of foreign currency exchange rate change | 2 | 4 |
| Balance at end of period | 108 | 107 |

At March 31, 2011, the Company had a provision of \$108 million for environmental matters and other asset retirement obligations (2010 - \$107 million). Additional costs, not known or identifiable, could be incurred for remediation efforts.

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NOTE 11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Climate change regulation

Since 1997, when an international conference on global warming concluded an agreement known as the Kyoto Protocol, which called for reductions of certain emissions that may contribute to increases in atmospheric greenhouse gas ("GHG") concentrations, various international, national and local laws have been proposed or implemented focusing on reducing GHG emissions. These actual or proposed laws do or may apply in the countries where the Company currently has, or may have in the future, manufacturing facilities or investments.

In the United States, both the Senate and Congress have, in the last two years, considered legislation to reduce emissions of GHGs. In addition, several states are already requiring the reduction of GHG emissions by certain companies and public utilities, primarily through the planned development of GHG emission inventories and/or state GHG cap-and-trade programs. Furthermore, the U.S. Environmental Protection Agency ("EPA") has begun the process of regulating GHG via the Clean Air Act. Passage of climate control legislation or other regulatory initiatives by the Senate, Congress or various U.S. states, or the adoption of regulations by the EPA or analogous state agencies that restrict emissions of GHGs in areas in which the Company conducts business may have a material effect on the Company's operations. The Company expects not to be disproportionately affected by these measures compared with other pulp and paper operations in the United States. There are presently no federal or provincial legislations on regulatory obligations to reduce GHG for the Company's pulp and paper operations in Canada.

While it is likely that there will be increased regulation relating to GHG and climate change, at this stage it is not possible to estimate either a timetable for the promulgation or implementation of any new regulations or the Company's cost of compliance to said regulations.

Industrial Boiler Maximum Achievable Controlled Technology Standard ("MACT")

The EPA has proposed several standards related to emissions from boilers and process heaters included in the Company's manufacturing processes. These standards are referred to as Boiler MACT. A final rule was released in late February 2011, however, the EPA has provided for a process referred to as "reconsideration" for certain portions of the final rule, thus delaying enactment and making uncertain what actions the agency will take with those portions of the rule subject to reconsideration. Compliance with Boiler MACT will be required three years after the February 2011 date of enactment although such timing could be changed as the final rule may be altered as a result of reconsiderations.

It is apparent that owners and operators of industrial boilers and process heaters will be required to address multiple emission standards in order to comply with the final rule. Until a final rule is enacted, it is not possible to provide an estimated cost of compliance, but compliance may have a significant impact on the Company's results of operations, financial position or cash flows.

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 31, 2011, 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, results of operations or cash flows.

The pulp and paper mill in Prince Albert was closed in the first quarter of 2006 and has not been operated since. In December 2009, the Company decided to dismantle the Prince Albert facility. In a grievance relating to the closure of the Prince Albert facility, 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 still had recall rights during the layoff. Arbitration in this matter was held in February 2010, and the arbitrator ruled in favor of the Company on August 24, 2010. As a result of the sale of the Prince Albert facility to Paper Excellence, the union agreed to release any claims for judicial review it may have against Domtar in relation to the grievance.

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NOTE 11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

On July 31, 1998, Domtar Inc. (now a 100% owned subsidiary of Domtar Corporation) 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 included 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 be required to pay an increase in consideration of up to a maximum of \$123 million (CDN\$120 million), an amount gradually declining over a 25-year period. At March 7, 2007, the maximum amount of the purchase price adjustment was approximately \$113 million (CDN\$110 million).

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 \$113 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 \$113 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 Company's financial position, results of operations or cash flows. On March 31, 2011, George Weston Limited filed a motion for summary judgment which Domtar expects to be resolved by the Court in due course. No provision is recorded for this potential purchase price adjustment.

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 31, 2011, 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 provision has been recorded. These indemnifications have not yielded a significant expense in the past.

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NOTE 12. SEGMENT DISCLOSURES

Following the sale of the Wood business on June 30, 2010, the Company's reporting segments correspond to the following business activities: Papers and Paper Merchants. Prior to June 30, 2010, the Company operated 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 of business, commercial printing and publishing, and converting and specialty papers, as well as market softwood, fluff and hardwood 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 interest expense and income taxes.

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NOTE 12. SEGMENT DISCLOSURES (CONTINUED)

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

| SEGMENT DATA | For the three months ended | |
|--|-----------------------------------|---------------------------|
| | March 31, 2011 | March 31, 2010 |
| | \$ | \$ |
| Sales | | |
| Papers | 1,269 | 1,245 |
| Paper Merchants | 217 | 212 |
| Wood | — | 67 |
| Total for reportable segments | <u>1,486</u> | <u>1,524</u> |
| Intersegment sales – Papers | (63) | (62) |
| Intersegment sales – Wood | — | (5) |
| Consolidated sales | <u>1,423</u> | <u>1,457</u> |
| Depreciation and amortization and impairment and write-down of property, plant and equipment | | |
| Papers | 92 | 96 |
| Paper Merchants | 1 | 1 |
| Wood | — | 5 |
| Total for reportable segments | <u>93</u> | <u>102</u> |
| Impairment and write-down of property, plant and equipment – Papers | 3 | 22 |
| Consolidated depreciation and amortization and impairment and write-down of property, plant and equipment | <u>96</u> | <u>124</u> |
| Operating income (loss) | | |
| Papers ^(a) | 209 | 120 |
| Paper Merchants | 3 | 1 |
| Wood | — | (5) |
| Corporate | (1) | — |
| Consolidated operating income | <u>211</u> | <u>116</u> |
| Interest expense, net | 21 | 32 |
| Earnings before income taxes | <u>190</u> | <u>84</u> |
| Income tax expense | 57 | 26 |
| Net earnings | <u>133</u> | <u>58</u> |

- (a) The U.S. Internal Revenue Code of 1986, as amended (the "Code") permitted a refundable excise tax credit, until the end of 2009, for the production and use of alternative bio fuel mixtures derived from biomass. The Company submitted an application with the IRS to be registered as an alternative fuel mixer and received notification that its registration had been accepted in March 2009. The Company began producing and consuming alternative fuel mixtures in February 2009 at its eligible mills. Although the credit ended at the end of 2009, in 2010, the Company recorded \$25 million of such credits in Other operating income on the Consolidated Statement of Earnings. The \$25 million represented an adjustment to amounts presented as deferred revenue at December 31, 2009 and was released to income following guidance issued by the IRS in March 2010.

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NOTE 13. 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 that are fully and unconditionally guaranteed by Domtar Paper Company, LLC, a 100% owned subsidiary of the Company and the successor to the Weyerhaeuser Fine Paper Business U.S. Operations, Domtar Industries Inc. (and subsidiaries, excluding Domtar Funding LLC), Ariva Distribution Inc. and Domtar A.W., LLC (and subsidiary) all 100% owned subsidiaries of the Company ("Guarantor Subsidiaries"), on a joint and several basis. The Guaranteed Debt will not be guaranteed by certain of Domtar Paper Company LLC's own 100% owned subsidiaries; including Domtar Delaware Investments Inc., Domtar Delaware Holdings Inc., Domtar Delaware Holdings LLC and Domtar Inc. (collectively the "Non-Guarantor Subsidiaries").

The following supplemental condensed consolidating financial information sets forth, on an unconsolidated basis, the Balance Sheets at March 31, 2011 and December 31, 2010 and the Statements of Earnings (Loss), and Cash Flows for the three months ended March 31, 2011 and March 31, 2010 for Domtar Corporation (the "Parent"), and on a combined basis 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 in the Guarantor Subsidiaries, as well as the investments of the Guarantor Subsidiaries in the Non-Guarantor Subsidiaries, using the equity method.

| <u>CONDENSED CONSOLIDATING STATEMENT OF EARNINGS (LOSS)</u> | <u>For the three months ended March 31, 2011</u> | | | | |
|---|--|-----------------------------------|--|--------------------------------------|---------------------|
| | <u>Parent</u> | <u>Guarantor Subsidiaries</u> | <u>Non- Guarantor Subsidiaries</u> | <u>Consolidating Adjustments</u> | <u>Consolidated</u> |
| | \$ | \$ | \$ | \$ | \$ |
| Sales | — | 1,186 | 472 | (235) | 1,423 |
| Operating expenses | | | | | |
| Cost of sales, excluding depreciation and amortization | — | 908 | 348 | (235) | 1,021 |
| Depreciation and amortization | — | 68 | 25 | — | 93 |
| Selling, general and administrative | 9 | 89 | (8) | — | 90 |
| Impairment and write-down of property, plant and equipment | — | 3 | — | — | 3 |
| Closure and restructuring costs | — | 9 | 2 | — | 11 |
| Other operating income, net | — | (5) | (1) | — | (6) |
| | <u>9</u> | <u>1,072</u> | <u>366</u> | <u>(235)</u> | <u>1,212</u> |
| Operating income (loss) | (9) | 114 | 106 | — | 211 |
| Interest expense (income), net | 23 | 15 | (17) | — | 21 |
| Earnings (loss) before income taxes | (32) | 99 | 123 | — | 190 |
| Income tax expense (benefit) | (10) | 30 | 37 | — | 57 |
| Share in earnings of equity accounted investees | 155 | 86 | — | (241) | — |
| Net earnings (loss) | <u>133</u> | <u>155</u> | <u>86</u> | <u>(241)</u> | <u>133</u> |

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NOTE 13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

| CONDENSED CONSOLIDATING STATEMENT OF EARNINGS (LOSS) | For the three months ended March 31, 2010 | | | | |
|---|--|-----------------------------------|--|--------------------------------------|---------------------|
| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| | \$ | \$ | \$ | \$ | \$ |
| Sales | — | 1,191 | 486 | (220) | 1,457 |
| Operating expenses | | | | | |
| Cost of sales, excluding depreciation and amortization | — | 977 | 385 | (220) | 1,142 |
| Depreciation and amortization | — | 73 | 29 | — | 102 |
| Selling, general and administrative | 7 | 55 | 22 | — | 84 |
| Impairment and write-down of property, plant and equipment | — | 22 | — | — | 22 |
| Closure and restructuring costs | — | 17 | 3 | — | 20 |
| Other operating income, net | — | (24) | (5) | — | (29) |
| | 7 | 1,120 | 434 | (220) | 1,341 |
| Operating income (loss) | (7) | 71 | 52 | — | 116 |
| Interest expense (income), net | 31 | 15 | (14) | — | 32 |
| Earnings (loss) before income taxes | (38) | 56 | 66 | — | 84 |
| Income tax expense (benefit) | (11) | 19 | 18 | — | 26 |
| Share in earnings of equity accounted investees | 85 | 48 | — | (133) | — |
| Net earnings (loss) | 58 | 85 | 48 | (133) | 58 |

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NOTE 13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

| CONDENSED CONSOLIDATING BALANCE SHEET | March 31, 2011 | | | | |
|---|-----------------------|-----------------------------------|--|--------------------------------------|---------------------|
| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| | \$ | \$ | \$ | \$ | \$ |
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 385 | — | 219 | — | 604 |
| Receivables | 1 | 502 | 218 | — | 721 |
| Inventories | — | 445 | 198 | — | 643 |
| Prepaid expenses | 4 | 7 | 21 | — | 32 |
| Income and other taxes receivable | 52 | — | 34 | (32) | 54 |
| Intercompany accounts | 359 | 2,872 | 115 | (3,346) | — |
| Deferred income taxes | 1 | 105 | 10 | — | 116 |
| Total current assets | 802 | 3,931 | 815 | (3,378) | 2,170 |
| Property, plant and equipment, at cost | — | 5,534 | 3,802 | — | 9,336 |
| Accumulated depreciation | — | (3,058) | (2,567) | — | (5,625) |
| Net property, plant and equipment | — | 2,476 | 1,235 | — | 3,711 |
| Intangible assets, net of amortization | — | 11 | 46 | — | 57 |
| Investments in affiliates | 6,609 | 1,828 | — | (8,437) | — |
| Intercompany long-term advances | 6 | 80 | 909 | (995) | — |
| Other assets | 29 | — | 194 | (20) | 203 |
| Total assets | 7,446 | 8,326 | 3,199 | (12,830) | 6,141 |
| Liabilities and shareholders' equity | | | | | |
| Current liabilities | | | | | |
| Bank indebtedness | — | 21 | 4 | — | 25 |
| Trade and other payables | 39 | 319 | 303 | — | 661 |
| Intercompany accounts | 2,936 | 370 | 40 | (3,346) | — |
| Income and other taxes payable | — | 30 | 23 | (32) | 21 |
| Long-term debt due within one year | — | 2 | — | — | 2 |
| Total current liabilities | 2,975 | 742 | 370 | (3,378) | 709 |
| Long-term debt | 803 | 10 | 12 | — | 825 |
| Intercompany long-term loans | 389 | 606 | — | (995) | — |
| Deferred income taxes and other | — | 947 | 28 | (20) | 955 |
| Other liabilities and deferred credits | 49 | 68 | 247 | — | 364 |
| Shareholders' equity | 3,230 | 5,953 | 2,542 | (8,437) | 3,288 |
| Total liabilities and shareholders' equity | 7,446 | 8,326 | 3,199 | (12,830) | 6,141 |

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

| CONDENSED CONSOLIDATING BALANCE SHEET | December 31, 2010 | | | | |
|---|--------------------------|-----------------------------------|--|--------------------------------------|---------------------|
| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| | \$ | \$ | \$ | \$ | \$ |
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 311 | 50 | 169 | — | 530 |
| Receivables | 4 | 416 | 181 | — | 601 |
| Inventories | — | 477 | 171 | — | 648 |
| Prepaid expenses | 5 | 6 | 17 | — | 28 |
| Income and other taxes receivable | 47 | — | 33 | (2) | 78 |
| Intercompany accounts | 367 | 2,797 | 291 | (3,455) | — |
| Deferred income taxes | 1 | 104 | 10 | — | 115 |
| Total current assets | <u>735</u> | <u>3,850</u> | <u>872</u> | <u>(3,457)</u> | <u>2,000</u> |
| Property, plant and equipment, at cost | — | 5,537 | 3,718 | — | 9,255 |
| Accumulated depreciation | — | (2,993) | (2,495) | — | (5,488) |
| Net property, plant and equipment | — | 2,544 | 1,223 | — | 3,767 |
| Intangible assets, net of amortization | — | 10 | 46 | — | 56 |
| Investments in affiliates | 6,421 | 1,742 | — | (8,163) | — |
| Intercompany long-term advances | 6 | 80 | 871 | (957) | — |
| Other assets | 27 | 1 | 189 | (14) | 203 |
| Total assets | <u>7,189</u> | <u>8,227</u> | <u>3,201</u> | <u>(12,591)</u> | <u>6,026</u> |
| Liabilities and shareholders' equity | | | | | |
| Current liabilities | | | | | |
| Bank indebtedness | — | 19 | 4 | — | 23 |
| Trade and other payables | 33 | 375 | 270 | — | 678 |
| Intercompany accounts | 2,825 | 399 | 231 | (3,455) | — |
| Income and other taxes payable | — | 2 | 22 | (2) | 22 |
| Long-term debt due within one year | — | 2 | — | — | 2 |
| Total current liabilities | <u>2,858</u> | <u>797</u> | <u>527</u> | <u>(3,457)</u> | <u>725</u> |
| Long-term debt | 803 | 10 | 12 | — | 825 |
| Intercompany long-term loans | 351 | 606 | — | (957) | — |
| Deferred income taxes and other | — | 920 | 18 | (14) | 924 |
| Other liabilities and deferred credits | 39 | 66 | 245 | — | 350 |
| Shareholders' equity | <u>3,138</u> | <u>5,828</u> | <u>2,399</u> | <u>(8,163)</u> | <u>3,202</u> |
| Total liabilities and shareholders' equity | <u>7,189</u> | <u>8,227</u> | <u>3,201</u> | <u>(12,591)</u> | <u>6,026</u> |

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DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

| CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS | For the three months ended March 31, 2011 | | | | |
|---|--|-----------------------------------|--|--------------------------------------|---------------------|
| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| | \$ | \$ | \$ | \$ | \$ |
| Operating activities | | | | | |
| Net earnings | 133 | 155 | 86 | (241) | 133 |
| Changes in operating and intercompany assets and liabilities and non-cash items, included in net earnings | (28) | (199) | 1 | 241 | 15 |
| Cash flows provided from (used for) operating activities | 105 | (44) | 87 | — | 148 |
| Investing activities | | | | | |
| Additions to property, plant and equipment | — | (11) | (2) | — | (13) |
| Proceeds from disposals of property, plant and equipment | — | 9 | — | — | 9 |
| Proceeds from sale of business | — | 4 | — | — | 4 |
| Cash flows provided from (used for) investing activities | — | 2 | (2) | — | — |
| Financing activities | | | | | |
| Dividend payments | (11) | — | — | — | (11) |
| Net change in bank indebtedness | — | 3 | — | — | 3 |
| Repayment of long-term debt | — | (1) | — | — | (1) |
| Stock repurchase | (69) | — | — | — | (69) |
| Increase in long-term advances to related parties | — | (10) | (35) | 45 | — |
| Decrease in long-term advances to related parties | 45 | — | — | (45) | — |
| Other | 4 | — | — | — | 4 |
| Cash flows used for financing activities | (31) | (8) | (35) | — | (74) |
| Net increase (decrease) in cash and cash equivalents | 74 | (50) | 50 | — | 74 |
| Cash and cash equivalents at beginning of period | 311 | 50 | 169 | — | 530 |
| Cash and cash equivalents at end of period | 385 | — | 219 | — | 604 |

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DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 13. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

| CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS | For the three months ended March 31, 2010 | | | | |
|--|--|-----------------------------------|--|--------------------------------------|---------------------|
| | Parent | Guarantor Subsidiaries | Non- Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
| | \$ | \$ | \$ | \$ | \$ |
| Operating activities | | | | | |
| Net earnings (loss) | 58 | 85 | 48 | (133) | 58 |
| Changes in operating and intercompany assets and liabilities and non-cash items, included in net earnings (loss) | 44 | (56) | (56) | 133 | 65 |
| Cash flows provided from (used for) operating activities | <u>102</u> | <u>29</u> | <u>(8)</u> | <u>—</u> | <u>123</u> |
| Investing activities | | | | | |
| Additions to property, plant and equipment | — | (26) | (5) | — | (31) |
| Proceeds from disposals of property, plant and equipment | — | — | 7 | — | 7 |
| Increase in long-term advances to related parties | (2) | (17) | — | 19 | — |
| Decrease in long-term advances to related parties | — | — | 19 | (19) | — |
| Cash flows provided from (used for) investing activities | <u>(2)</u> | <u>(43)</u> | <u>21</u> | <u>—</u> | <u>(24)</u> |
| Financing activities | | | | | |
| Net change in bank indebtedness | — | (16) | (7) | — | (23) |
| Repayment of long-term debt | (102) | (1) | — | — | (103) |
| Borrowings under accounts receivable securitization program | — | — | 20 | — | 20 |
| Other | (3) | — | — | — | (3) |
| Cash flows provided from (used for) financing activities | <u>(105)</u> | <u>(17)</u> | <u>13</u> | <u>—</u> | <u>(109)</u> |
| Net increase (decrease) in cash and cash equivalents | (5) | (31) | 26 | — | (10) |
| Cash and cash equivalents at beginning of period | 237 | 83 | 4 | — | 324 |
| Cash and cash equivalents at end of period | <u>232</u> | <u>52</u> | <u>30</u> | <u>—</u> | <u>314</u> |

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2011
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. SUBSEQUENT EVENT

On May 3, 2011, the Company sold its Prince Albert, Saskatchewan assets to Paper Excellence Canada Holdings Corporation ("Paper Excellence"). The assets sold to Paper Excellence had no carrying value and the sale will result in a loss on disposal of the assets and related pension and other post-retirement benefit plan curtailments and settlements net of a reversal of environmental liability provision of approximately \$13 million (CDN\$12 million) which will be recorded in the second quarter of 2011. The Prince Albert mill was permanently closed in the second quarter of 2006 and has not been operated since. Domtar acquired the assets in 2007 as part of a transaction with Weyerhaeuser Company. Domtar completed the dismantling of the mill's paper machine and converting equipment in 2008.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("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 31, 2010, filed with the Securities and Exchange Commission ("SEC") on February 25, 2011. Throughout this 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").

In accordance with industry practice, in this report, the term "ton" or the symbol "ST" refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tons. The term "metric ton" or the symbol "ADMT" refers 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 three-month periods ended March 31, 2011 and 2010. The three-month periods are also referred to as the first quarter of 2011 and 2010.

EXECUTIVE SUMMARY

In the first quarter of 2011, we reported operating income of \$211 million, an increase of \$56 million compared to operating income of \$155 million in the fourth quarter of 2010. This increase was attributable to an improvement in our paper business in the first quarter of 2011, which experienced a 7% volume increase compared to the fourth quarter of 2010, as well as higher average selling prices for pulp, compared to the fourth quarter of 2010. The results for our first quarter of 2011 were also impacted by lower costs related to maintenance, partially offset by higher costs for chemicals, lower average selling prices for paper and the unfavorable impact of a stronger Canadian dollar, net of our hedging program.

Paper shipments are expected to decline moderately throughout 2011. The announced closure of a paper machine at our Ashdown, Arkansas mill will help balance our production to our customer demand. Rising commodity and energy prices are expected to put pressure on some of our input costs in 2011 however we are expected to benefit from our recently announced price increases for softwood pulp and for commercial printing and converting papers. We will continue to manage our business conservatively, looking to grow profitably and to create sustainable long-term shareholder value.

Restructuring activities

We regularly review our overall production capacity with the objective of aligning our production capacity with anticipated long-term demand.

On March 29, 2011, we announced that no later than July 1, 2011, we will permanently shut down one paper machine at our Ashdown, Arkansas pulp and paper mill. The closure will result in an aggregate pre-tax charge to earnings of approximately \$80 million, which includes an estimated \$77 million in non-cash charges relating to the accelerated depreciation of the carrying amounts of manufacturing equipment and the write-off of related spare parts and \$3 million related to other costs. Of the estimated total pre-tax charge of approximately \$80 million, \$7 million was recognized in the first quarter of 2011 and \$73 million is expected to be incurred in the second quarter of 2011. This closure will reduce Domtar's annual uncoated freesheet paper production capacity by approximately 125,000 short tons and the mill's workforce by approximately 110 employees.

On February 1, 2011, we announced the closure of our Langhorne, Pennsylvania forms converting center. The closure resulted in a charge to earnings of \$4 million for severance and termination costs. The closure affected 48 employees.

[Table of Contents](#)**RECENT DEVELOPMENTS**

On May 3, 2011, the Company sold its Prince Albert, Saskatchewan assets to Paper Excellence Canada Holdings Corporation ("Paper Excellence"). The assets sold to Paper Excellence had no carrying value and the sale will result in a loss on disposal of the assets and related pension and other post-retirement benefit plan curtailments and settlements net of a reversal of environmental liability provision of approximately \$13 million (CDN\$12 million) which will be recorded in the second quarter of 2011. The Prince Albert mill was permanently closed in the second quarter of 2006 and has not been operated since. Domtar acquired the assets in 2007 as part of a transaction with Weyerhaeuser Company. Domtar completed the dismantling of the mill's paper machine and converting equipment in 2008.

OUR BUSINESS

Our reporting segments correspond to the following business activities: Papers and Paper Merchants. 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 31, 2010.

CONSOLIDATED RESULTS OF OPERATIONS AND SEGMENT REVIEW

The following table includes the consolidated financial results of Domtar Corporation for the first quarter of 2011 and 2010.

| FINANCIAL HIGHLIGHTS | Three months ended | |
|---|----------------------------------|-------------------------------------|
| | March 31, 2011 | March 31, 2010 |
| <i>(In millions of dollars, unless otherwise noted)</i> | | |
| Sales | \$ 1,423 | \$ 1,457 |
| Operating income | 211 | 116 |
| Net earnings | 133 | 58 |
| Net earnings per common share (in dollars) ¹ : | | |
| Basic | 3.16 | 1.35 |
| Diluted | 3.14 | 1.34 |
| Operating income (loss) per segment: | | |
| Papers | \$ 209 | \$ 120 |
| Paper Merchants | 3 | 1 |
| Wood | — | (5) |
| Corporate | (1) | — |
| Total | \$ 211 | \$ 116 |
| | At March 31, 2011 | At December 31, 2010 |
| Total assets | \$ 6,141 | \$ 6,026 |
| Total long-term debt, including current portion | \$ 827 | \$ 827 |

¹ Refer to Note 4 of the consolidated financial statements included in Item 1, for more information on the calculation of net earnings per common share.

**FIRST QUARTER 2011 VERSUS
FIRST QUARTER 2010**

Sales

Sales for the first quarter of 2011 amounted to \$1,423 million, a decrease of \$34 million, or 2%, from sales of \$1,457 million in the first quarter of 2010. This decrease in sales was mainly attributable to the sale of our Wood business in the second quarter of 2010 (\$62 million) as well as to lower shipments for paper and pulp (\$59 million) due to the closure of our coated groundwood paper mill in Columbus, Mississippi in the second quarter of 2010 and the sale of our Woodland hardwood market pulp mill in the third quarter of 2010. These factors were partially offset by higher average selling prices for paper and pulp (\$82 million).

Cost of Sales, excluding Depreciation and Amortization

Cost of sales, excluding depreciation and amortization, amounted to \$1,021 million in the first quarter of 2011, a decrease of \$121 million, or 11%, compared to cost of sales, excluding depreciation and amortization, of \$1,142 million in the first quarter of 2010. This decrease was mainly attributable to the sale of our Wood business in the second quarter of 2010 (\$61 million) as well as to lower shipments for paper and pulp (\$36 million), due to the closure of our coated groundwood paper mill in Columbus, Mississippi in the second quarter of 2010 and the sale of our Woodland hardwood market pulp mill in the third quarter of 2010. This decrease was also attributable to lower costs for fiber (\$11 million) and energy (\$18 million). These factors were partially offset by higher costs for chemicals (\$9 million), freight (\$7 million) and the negative impact of a stronger Canadian dollar on our Canadian denominated expenses, net of our hedging program (\$9 million).

Depreciation and Amortization

Depreciation and amortization amounted to \$93 million in the first quarter of 2011, a decrease of \$9 million, or 9%, compared to depreciation and amortization of \$102 million in the first quarter of 2010. This decrease was mainly due to the sale of our Wood business in the second quarter of 2010 as well as to the sale of our Woodland, Maine mill in the third quarter of 2010.

Selling, General and Administrative Expenses ("SG&A")

SG&A expenses amounted to \$90 million in the first quarter of 2011, an increase of \$6 million, or 7%, compared to SG&A expenses of \$84 million in the first quarter of 2010. The increase in SG&A is primarily due to higher costs related to our variable compensation program of \$6 million in the first quarter of 2011 when compared to 2010.

Other Operating Income

Other operating income amounted to \$6 million in the first quarter of 2011, a decrease of \$23 million compared to other operating income of \$29 million in the first quarter of 2010. This decrease is primarily due to a refundable excise tax credit for the production and use of alternative bio fuel mixtures of \$25 million recorded in the first quarter of 2010.

Operating Income

Operating income in the first quarter of 2011 amounted to \$211 million, an increase of \$95 million compared to an operating income of \$116 million in the first quarter of 2010. This increase is primarily due to the factors mentioned above as well as due to lower impairment and write-down of property, plant and equipment and closure and restructuring costs (\$28 million).

Interest Expense

We incurred \$21 million of interest expense in the first quarter of 2011, a decrease of \$11 million compared to interest expense of \$32 million in the first quarter of 2010. The decrease in interest expense is primarily related to a lower long-term debt balance outstanding in the first quarter of 2011 compared to the first quarter of 2010.

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Income Taxes

For the first quarter of 2011, our income tax expense amounted to \$57 million, which was comprised of \$28 million of current tax expense and \$29 million of deferred tax expense, compared to expense of \$26 million in the first quarter of 2010, which was comprised of current tax expense of \$11 million and deferred tax expense of \$15 million. We made income tax payments of \$2 million during the first quarter of 2011. In the first quarter of 2011, our effective tax rate was 30% compared to an effective tax rate of 31% in the first quarter of 2010. The effective tax rate for the first quarter of 2011 was impacted by state tax credits received during the quarter worth approximately \$3 million, net of a valuation allowance.

Net Earnings

Net earnings amounted to \$133 million (\$3.14 per common share on a diluted basis) in the first quarter of 2011, an increase of \$75 million compared to \$58 million (\$1.34 per common share on a diluted basis) in the first quarter of 2010 due to the factors mentioned above.

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PAPERS

| SELECTED INFORMATION | Three months ended | |
|---|---------------------------|-----------------------|
| | March 31, 2011 | March 31, 2010 |
| <i>(In millions of dollars, unless otherwise noted)</i> | | |
| Sales | | |
| Total sales | \$ 1,269 | \$ 1,245 |
| Intersegment sales | (63) | (62) |
| | \$ 1,206 | \$ 1,183 |
| Operating income | \$ 209 | \$ 120 |
| Shipments | | |
| Paper (in thousands of ST) | 913 | 960 |
| Pulp (in thousands of ADMT) | 375 | 388 |

Sales and Operating Income*Sales*

Sales in our Papers segment amounted to \$1,206 million in the first quarter of 2011, an increase of \$23 million, or 2%, compared to sales of \$1,183 million in the first quarter of 2010. The increase in sales is attributable to higher average selling prices for paper and pulp. We took lower lack-of-order downtime and paper machine slowdowns in the first quarter of 2011 when compared to the first quarter of 2010, which positively impacted our earnings. These factors were partially offset by lower shipments for paper of approximately 5%, and pulp of approximately 3% due to the closure of our coated groundwood paper mill in Columbus, Mississippi in the second quarter of 2010 and the sale of our Woodland hardwood market pulp mill in the third quarter of 2010.

Operating Income

Operating income in our Papers segment amounted to \$209 million in the first quarter of 2011, an increase of \$89 million, when compared to \$120 million in the first quarter of 2010. The increase is mostly attributable to higher average selling prices for paper and pulp and lower costs for fiber and energy. These factors were partially offset by higher costs for chemicals, the unfavorable impact of a stronger Canadian dollar, the alternative fuel tax credits recorded in the first quarter of 2010 and lower shipments for paper and pulp.

Pricing Environment

Overall average sales prices in our paper business experienced an increase in the first quarter of 2011 compared to the first quarter of 2010. Our overall average paper sales prices were higher by \$51/ton, or 5%, in the first quarter of 2011 compared to the first quarter of 2010.

Our average pulp sales prices increased by \$104/metric ton, or 15%, in the first quarter of 2011 compared to the first quarter of 2010.

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Operations

Shipments

Our paper shipments decreased by 47,000 tons, or 5%, in the first quarter of 2011 compared to the first quarter of 2010, primarily due to the closure of our Columbus paper mill and the exit of the coated groundwood market in the second quarter of 2010.

Our pulp trade shipments decreased by 13,000 metric tons, or 3%, in the first quarter of 2011 compared to the first quarter of 2010, due to the sale of our Woodland, Maine mill in the third quarter of 2010. Excluding shipments from our Woodland, Maine mill, our pulp trade shipments increased by 80,000 metric tons, or 27%.

Labor

We have an umbrella agreement with the United Steelworkers Union ("USW"), expiring in 2012, affecting approximately 3,000 employees at our U.S. locations. This agreement only covers certain economic elements, and all other issues are negotiated at each operating location, as the related collective bargaining agreements become subject to renewal. The parties have agreed not to strike or lock-out during the terms of the respective local agreements. Should the parties fail to reach an agreement during the local negotiations, the related collective bargaining agreements are automatically renewed for another four years.

We have one collective agreement that expired in the first quarter of 2011 at our Kingsport, Tennessee facility. Local negotiations with the USW began in February 2011. A successful conclusion was reached and it was ratified by the membership on February 24, 2011.

We have four collective agreements that expired in 2010, one of which expired in April at our Windsor facility in Quebec, Canada, which is currently in negotiation with the Confederation of National Trade Unions ("CNTU"), two that expired in May at our Nekoosa, Wisconsin facility, for which negotiations have been completed with two ratification agreements, and one that expired in August at our Hawesville, Kentucky facility, for which negotiations are completed and the terms of the USW umbrella agreement applies.

Agreements that expired in 2009 at our Dryden and Espanola facilities in Canada are scheduled for negotiation with the Communication, Energy and Paperworkers Union of Canada ("CEP"). In Espanola, negotiations started in late 2010 while in Dryden, negotiations are delayed at this time. These Canadian collective agreements are unrelated to the umbrella agreement with the USW covering our U.S. locations.

Closure and Restructuring

On March 29, 2011, we announced that no later than July 1, 2011, we will permanently shut down one paper machine at our Ashdown, Arkansas pulp and paper mill. The closure will result in an aggregate pre-tax charge to earnings of approximately \$80 million, which includes an estimated \$77 million in non-cash charges relating to the accelerated depreciation of the carrying amounts of manufacturing equipment and the write-off of related spare parts and \$3 million related to other costs. Of the estimated total pre-tax charge of approximately \$80 million, \$7 million was recognized in the first quarter of 2011 and \$73 million is expected to be incurred in the second quarter of 2011. This closure will reduce our annual uncoated freesheet paper production capacity by approximately 125,000 short tons and the mill's workforce by approximately 110 employees.

On February 1, 2011, we announced the closure of our Langhorne, Pennsylvania forms converting center. The closure resulted in a charge to earnings of \$4 million for severance and termination costs. The closure will affect approximately 48 employees.

In the first quarter of 2011, we incurred \$14 million of closure and restructuring costs (\$42 million in the first quarter of 2010), including the impairment and write-down of property, plant and equipment of \$3 million, compared to \$22 million in the first quarter of 2010. For more details on the closure and restructuring costs, refer to Item 1, Financial Statements and Supplementary Data, Note 8, of this Quarterly Report on Form 10-Q.

Closure and restructuring costs are based on management's best estimates. Although the Company does not anticipate significant changes, the actual costs may differ from these estimates due to subsequent developments such as the results of environmental studies, the ability to find a buyer for assets set to be dismantled and demolished and other business developments. As such, additional costs and further write-downs may be required in future periods.

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Other

Natural Resources Canada Pulp and Paper Green Transformation Program

On June 17, 2009, the Government of Canada announced that it was developing a Pulp and Paper Green Transformation Program ("the Green Transformation Program") to help pulp and paper companies make investments to improve the environmental performance of their Canadian facilities. The Green Transformation Program is capped at CDN\$1 billion. The funding of capital investments at eligible mills must be completed no later than March 31, 2012 and all projects are subject to the approval of the Government of Canada.

Eligible projects must demonstrate an environmental benefit by either improving energy efficiency or increasing renewable energy production. Although amounts will not be received until qualifying capital expenditures have been made, we have been allocated \$147 million (CDN\$143 million) through this Green Transformation Program, of which \$146 million (CDN\$142 million) has been approved to date. The funds are to be spent on capital projects to improve energy efficiency and environmental performance in our Canadian pulp and paper mills and any amounts received will be accounted for as an offset to the applicable plant and equipment asset amount. As of April 30, 2011, we have received \$88 million (CDN\$86 million) mostly related to eligible projects at our Kamloops, Dryden and Windsor pulp and paper mills.

Cellulosic Biofuel Credit

In July 2010, the US Internal Revenue Service ("IRS") Office of Chief Counsel released an Advice Memorandum concluding that qualifying cellulose biofuel sold or used before January 1, 2010, qualifies for the cellulosic biofuel producer credit ("CBPC") and will not be required to be registered by the Environmental Protection Agency. Each gallon of qualifying cellulose biofuel produced by any taxpayer operating a pulp and paper mill and used as a fuel in the taxpayer's trade or business during calendar year 2009 will qualify for the \$1.01 non-refundable CBPC. A taxpayer will be able to claim the credit on its federal income tax return for the 2009 tax year upon the receipt of a letter of registration from the IRS and any unused CBPC may be carried forward until 2015 to offset a portion of federal taxes otherwise payable.

In July 2010, we submitted an application with the IRS to be registered for the CBPC and on September 28, 2010, we received our notification from the IRS that we are successfully registered. On October 15, 2010 the IRS Office of Chief Counsel released an Advice Memorandum concluding that the AFMC and CBPC could be claimed in the same year for different volumes of black liquor. In November, 2010, we filed an amended 2009 tax return with the IRS claiming a cellulosic biofuel producer credit of \$209 million. As of December 31, 2010, approximately \$170 million of this credit remains to offset future U.S. federal income tax liability. We expect to utilize a significant portion of this credit during 2011 to offset required federal income tax installments.

Alternative Fuel Tax Credits

The U.S. Internal Revenue Code of 1986, as amended (the "Code") permitted a refundable excise tax credit, until the end of 2009, for the production and use of alternative bio fuel mixtures derived from biomass. We submitted an application with the IRS to be registered as an alternative fuel mixer and received notification that our registration had been accepted in late March 2009. We began producing and consuming alternative fuel mixtures in February 2009 at our eligible mills. The amounts for the refundable credits are based on the volume of alternative bio fuel mixtures produced and burned during that period. To date, we have received \$508 million refund, net of federal income tax offsets. There has been no change in the Company's status with respect to the alternative fuel mixture credits previously claimed but we continue to assess the possibility of converting these credits into additional cellulosic biofuel producer credits. Any such conversion would require the repayment of any alternative fuel tax credit refund previously received, along with interest, in exchange for a credit to be used against future federal income tax.

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PAPER MERCHANTS

| SELECTED INFORMATION | Three months ended | |
|---------------------------------|---------------------------|-----------------------|
| | March 31, 2011 | March 31, 2010 |
| <i>(In millions of dollars)</i> | | |
| Sales | \$ 217 | \$ 212 |
| Operating income | 3 | 1 |

Sales and Operating Income*Sales*

Sales in our Paper Merchants segment amounted to \$217 million in the first quarter of 2011, an increase of \$5 million compared to sales of \$212 million in the first quarter of 2010. This increase in sales was mostly attributable to an increase in selling prices, partially offset by a decrease in deliveries of approximately 2%.

Operating Income

Operating income amounted to \$3 million in the first quarter of 2011, an increase of \$2 million when compared to operating income of \$1 million in the first quarter of 2010. The increase in operating income is attributable to a gain on sale of a small business unit (\$3 million).

Operations*Labor*

We have collective agreements covering six locations in the U.S., of which one expired in 2010, one will expire in 2011 and four will expire in 2013. We have four collective agreements covering four locations in Canada, of which one expired in 2008, one expired in 2009 and two expired in 2010.

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WOOD

| SELECTED INFORMATION | Three months ended | |
|---|---------------------------|-----------------------|
| | March 31, 2011 | March 31, 2010 |
| <i>(In millions of dollars, unless otherwise noted)</i> | | |
| Sales | | |
| Total sales | \$ — | \$ 67 |
| Intersegment sales | — | (5) |
| | \$ — | \$ 62 |
| Operating loss | \$ — | (\$ 5) |
| Shipments (millions of FBM) | — | 164 |
| Benchmark prices¹: | | |
| Lumber G.L. 2x4x8 stud (\$/MFBM) | \$ — | \$ 337 |
| Lumber G.L. 2x4 R/L no. 1 & no. 2 (\$/MFBM) | — | 343 |

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

Sale of Wood business

On June 30, 2010, the Company sold its Wood business to EACOM Timber Corporation and exited the manufacturing and marketing of lumber and wood-based value-added products.

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STOCK-BASED COMPENSATION EXPENSE

For the first quarter of 2011, compensation expense recognized in our results of operations was approximately \$12 million, compared to \$6 million in the first quarter of 2010. Compensation costs for performance awards are based on management's best estimate of the final performance measurement.

LIQUIDITY AND CAPITAL RESOURCES

Our principal cash requirements are for ongoing operating costs, pension contributions, 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 contractually committed revolving credit facility of which \$702 million is currently undrawn and available. Under extreme market condition, there can be no assurance that this agreement would be available or sufficient. See "Capital Resources" below.

Our ability to make payments on and to refinance our indebtedness, including debt we have incurred under the credit facility and outstanding Domtar Corporation notes, and for ongoing operating costs including pension contributions, working capital and capital expenditures, as well as principal and interest payments on our debt, 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 facility and debt indentures, as well as terms of any future indebtedness, impose, or 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 \$148 million in the first quarter of 2011, a \$25 million increase compared to cash flows provided from operating activities of \$123 million in the first quarter of 2010. This increase in cash flows provided from operating activities is primarily related to an increase in profitability. These factors were offset by an increase in requirements for working capital in the first quarter of 2011 when compared to the first quarter of 2010 primarily due to an increase in receivables resulting from higher sales volumes in the first quarter of 2011 as compared to the fourth quarter of 2010.

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 2011 amounted to nil, a decrease of \$24 million compared to cash flows used for investing activities of \$24 million in the first quarter of 2010. This decrease in cash flows used for investing activities was impacted by lower capital spending of \$18 million in the first quarter of 2011 when compared to 2010, as well as higher proceeds from sale of business of \$4 million and from disposals of certain property, plant and equipment of \$2 million.

We intend to limit our annual capital expenditures to below 50% of annual depreciation expense in 2011, excluding the spending under the Natural Resources Canada Pulp and Paper Green Transformation Program, for which we will be reimbursed. We spent, and were reimbursed, \$23 million under this program in the first quarter of 2011.

Financing Activities

Cash flows used for financing activities totaled \$74 million in the first quarter of 2011 compared to \$109 million in the first quarter of 2010. This \$35 million decrease in cash flows used for financing activities is mainly attributable to the repayment of \$102 million of our tranche B term loan in the first quarter of 2010 versus \$69 million of stock repurchases and dividend payments of \$11 million in the first quarter of 2011.

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Capital Resources

Net indebtedness, consisting of bank indebtedness and long-term debt, net of cash and cash equivalents, was \$248 million at March 31, 2011, compared to \$320 million at December 31, 2010. The \$72 million decrease in net indebtedness is due to a higher cash level as a result of cash from operating activities net of cash used for financing activities being positive.

Our Credit Agreement consists of a \$750 million senior secured revolving credit facility. No amounts were borrowed at March 31, 2011 (December 31, 2010 – nil). At March 31, 2011, we had outstanding letters of credit amounting to \$48 million under this credit facility (December 31, 2010 – \$50 million). The revolving credit facility may be used by the Company, Domtar Paper Company, LLC and Domtar Inc. for general corporate purposes and a portion is available for letters of credit. Borrowings by the Company and Domtar Paper Company, LLC 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 revolving credit facility matures on March 7, 2012. 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, 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. As 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 2.5x and a consolidated debt to consolidated EBITDA (as defined under the Credit Agreement) ratio of less than 4.5x. At March 31, 2011, we were in compliance with our covenants.

A significant or prolonged downturn in general business and economic conditions may affect our ability to comply with our covenants or meet those financial ratios and tests and could require us to take action to reduce our debt or to act in a manner contrary to our current business objectives.

A breach of any of our Credit Agreement or indenture covenants or failure to maintain a required ratio or meet a required test may result in an event of default under those agreements. This may allow the counterparties to those agreements to declare all amounts outstanding thereunder, together with accrued interest, to be immediately due and payable. If this occurs, we may not be able to refinance the indebtedness on favorable terms, or at all, or repay the accelerated indebtedness.

The Company's direct and indirect, existing and future, U.S. 100% owned subsidiaries serve as guarantors of the senior secured credit facilities for any obligations thereunder of the U.S. borrowers, subject to 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.

On March 18, 2010, we entered into the Second Amendment to our Credit Agreement, dated March 7, 2007. The Second Amendment amended the Credit Agreement to permit the Company and its subsidiaries to make any optional or voluntary payment, prepayment, repurchase or redemption of or otherwise optionally or voluntarily defease or segregate funds with respect to all or a portion of the Company's Unsecured notes, so long as the consolidated senior secured leverage ratio of the Company does not exceed 1.5 to 1 and at least 50% of the revolving credit commitments under the credit agreement are unutilized, in each case at the time of prepayment and giving effect thereto.

Our obligations 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, other than 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.

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Domtar Canada Paper Inc. Exchangeable Shares

Upon the consummation of the combination of the Weyerhaeuser Fine Paper Business with Domtar Inc. on March 7, 2007, (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 31, 2011, there were 740,674 exchangeable shares issued and outstanding. The exchangeable shares of Domtar (Canada) Paper Inc. are intended to be substantially the economic 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, including, upon at least 60 days prior written notice to the holders, in the event less than 416,667 exchangeable shares (excluding any exchangeable shares held directly or indirectly by us) are outstanding at any time.

OFF BALANCE SHEET ARRANGEMENTS

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

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 matters. The terms of these indemnification agreements are generally for an unlimited period of time. At March 31, 2011, 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 shares of the Company to Weyerhaeuser shareholders. We will generally be required to indemnify Weyerhaeuser and Weyerhaeuser shareholders against any tax resulting from the Distribution if that tax results from an act or omission to act by us after the Distribution. If Weyerhaeuser, however, should recognize a gain on the Distribution for reasons not related to an act or omission to act by the Company after the Distribution, Weyerhaeuser would be responsible for such taxes and would not be entitled to indemnification by us under the Tax Sharing Agreement.

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 31, 2011, we had not recorded a liability associated with these indemnifications, as we do not expect to make any payments pertaining to these indemnifications.

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E.B. Eddy Acquisition

On July 31, 1998, Domtar Inc. (now a 100% owned subsidiary of Domtar Corporation) 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 be required to pay an increase in consideration of up to a maximum of \$123 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 approximately \$113 million (CDN\$110 million).

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 \$113 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 \$113 million (CDN\$110 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 financial position, results of operations or cash flows. On March 31, 2011, George Weston Limited filed a motion for summary judgment which we expect to be resolved by the Court in due course. No provision is recorded for this potential purchase price adjustment.

RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Changes Implemented

Stock Compensation

In April 2010, the FASB issued an update to Compensation – Stock Compensation, which addresses the classification of an employee share-based payment award with an exercise price denominated in the currency of a market in which the underlying security trades. This Update clarifies that those employee share-based payment awards should not be considered to contain a condition that is not a market, performance, or service condition and therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity.

This Update is effective for fiscal years and interim periods beginning on or after December 15, 2010 with early adoption permitted. The Company adopted the new required update effective January 1, 2011 with no impact on the Company's consolidated financial statements.

CRITICAL ACCOUNTING POLICIES

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, pension plans and other post-retirement benefit plans and income taxes based on currently available information. Actual results could differ from those estimates.

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 31, 2010, 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 to these critical accounting policies during the first quarter of 2011.

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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, Domtar Corporation's 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," "continue," "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 Domtar Corporation's results of operations or financial condition. These factors include, but are not limited to:

- conditions in the global capital and credit markets, and the economy generally, particularly in the U.S. and Canada;
- market demand for Domtar Corporation's products;
- product selling prices;
- raw material prices, including wood fiber, chemical and energy;
- performance of Domtar Corporation's manufacturing operations, including unexpected maintenance requirements;
- the level of competition from domestic and foreign producers;
- the effect of, or change in, forestry, land use, environmental and other governmental regulations (including tax), and accounting regulations;
- the effect of weather and the risk of loss from fires, floods, windstorms, hurricanes and other natural disasters;
- transportation costs;
- 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 Domtar Corporation's common stock on charges for stock-based compensation;
- performance of pension fund investments and related derivatives, if any; and
- the other factors described under "Risk Factors," in item 1A of the Annual Report on Form 10-K, for the year ended December 31, 2010.

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, Domtar Corporation assumes 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 31, 2010. There has not been any material change in our exposure to market risk since December 31, 2010. In the first quarter of 2011, we have updated the following disclosure.

COST RISK**Cash flow hedges**

We purchase natural gas and oil at the prevailing market price at the time of delivery. In order to manage the cash flow risk associated with purchases of natural gas and oil, we may utilize derivative financial instruments or physical purchases to fix the price of forecasted natural gas and oil purchases. We formally document the hedge relationships, including identification of the hedging instruments and the hedged items, the risk management objectives and strategies for undertaking the hedge transactions, and the methodologies used to assess effectiveness and measure ineffectiveness. Current contracts are used to hedge forecasted purchases over the next three years. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded as a component of Accumulated other comprehensive income (loss) within Shareholders' equity, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

The following table presents the volumes under derivative financial instruments for natural gas contracts outstanding as of March 31, 2011 to hedge forecasted purchases:

| Commodity | Notional contractual quantity under derivative contracts | | Notional contractual value under derivative contracts | Percentage of forecasted purchases under derivative contracts for | | |
|-------------|---|----------------------|--|--|------|------|
| | | | | 2011 | 2012 | 2013 |
| Natural gas | 6,105,000 | MMBTU ⁽¹⁾ | \$ 35 | 31% | 12% | 5% |

(1) MMBTU: Millions of British thermal units

The natural gas derivative contracts were fully effective for accounting purposes as of March 31, 2011. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the three months ended March 31, 2011 resulting from hedge ineffectiveness (2010 – nil).

FOREIGN CURRENCY RISK**Cash flow hedges**

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. 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 increases or decreases in the value of the Canadian dollar relative to the U.S. dollar. Our risk management policy allows us to hedge a significant portion of our exposure to fluctuations in foreign currency exchange rates for periods up to three years. We may use derivative instruments (currency options and foreign exchange forward contracts) to mitigate our exposure to fluctuations in foreign currency exchange rates. Foreign exchange forward 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.

We formally document the relationship between hedging instruments and hedged items, as well as our 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. Current contracts are used to hedge forecasted purchases over the next 12 months. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded as a component of Accumulated other comprehensive income (loss) within Shareholders' equity, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

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The following table presents the currency values under contracts pursuant to currency options outstanding as of March 31, 2011 to hedge forecasted purchases:

| <u>Contract</u> | | <u>Notional contractual value</u> | <u>Percentage of CDN denominated forecasted expenses, net of revenues, under contracts for</u> | |
|----------------------------|--------|---|--|-------------|
| | | | <u>2011</u> | <u>2012</u> |
| Currency options purchased | CDN \$ | 400 | 50% | 13% |
| Currency options sold | CDN \$ | 400 | 50% | 13% |

The currency options are fully effective as at March 31, 2011. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the first quarter of 2011 resulting from hedge ineffectiveness (2010 – nil).

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities 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 Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As of March 31, 2011, 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 31, 2011, our disclosure controls and procedures were effective.

Change in Internal Control 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.

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, if any, is found in Note 11 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 31, 2010, contains important risk factors that could cause our actual results to differ materially from those projected in any forward-looking statement. There were no material changes to the risk factors described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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

Share repurchase activity under our share repurchase program was as follows during the three-month period ended March 31, 2011:

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾ | (d) Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs (in 000s) |
|--|--------------------------------------|----------------------------------|---|--|
| January 1 through January 31, 2011 | — | \$ — | — | \$ 105,748 |
| February 1 through February 28, 2011 * | 725,621 | \$ 88.11 | 725,621 | \$ 41,814 |
| March 1 through March 31, 2011 | 64,336 | \$ 84.22 | 64,336 | \$ 36,396 |
| | <u>789,957</u> | <u>\$ 87.79</u> | <u>789,957</u> | |

* Includes 62,398 shares purchased for which contracts were signed in February but settlement occurred in March.

During the first quarter of 2011, the Company repurchased 789,957 shares at an average price of \$87.79 for a total cost of \$69 million under its stock repurchase program (the "Program") approved by the Board of Directors in May 2010. We currently have \$36 million of remaining availability under our Program. The Program may be suspended, modified or discontinued at any time and the Company has no obligation to repurchase any amount of its common stock under the Program. The Program has no set expiration date. The Company repurchases its common stock, from time to time, in part to reduce the dilutive effects of its stock options, awards, and employee stock purchase plan and to improve shareholders' returns. The timing and amount of stock repurchases will depend on a variety of factors, including the market conditions as well as corporate and regulatory considerations. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

On May 3, 2011, the Company's Board of Directors approved an increase to the Program from \$150 million to \$600 million.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

Not applicable.

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

Not applicable.

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.

Date: May 5, 2011

DOMTAR CORPORATION

By: /s/ DANIEL BURON

Daniel Buron

Senior Vice-President and Chief Financial Officer

By: /s/ RAZVAN L. THEODORU

Razvan L. Theodoru

Vice-President, Corporate Law and Secretary

Domtar Corporation

Computation of ratio of earnings to fixed charges
(In millions of dollars, unless otherwise noted)

| | <u>Three months ended</u> | |
|---|---------------------------------|---------------------------------|
| | <u>March 31,</u> <u>2011</u> | <u>March 31,</u> <u>2010</u> |
| | \$ | \$ |
| Available earnings: | | |
| Earnings before income taxes | 190 | 84 |
| Add fixed charges: | | |
| Interest expense incurred | 19 | 30 |
| Amortization of debt expense and discount | 2 | 2 |
| Interest portion of rental expense | 2 | 3 |
| Total earnings as defined | <u>213</u> | <u>119</u> |
| Fixed charges: | | |
| Interest expense incurred | 19 | 30 |
| Amortization of debt expense and discount | 2 | 2 |
| Interest portion of rental expense | 2 | 3 |
| Total fixed charges | <u>23</u> | <u>35</u> |
| Ratio of earnings to fixed charges | <u>9.3</u> | <u>3.4</u> |

CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, John D. Williams, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Domtar Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2011

/s/ John D. Williams

John D. Williams

President and Chief Executive Officer

CERTIFICATION BY THE CHIEF FINANCIAL OFFICER PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Daniel Buron, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Domtar Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affected, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 5, 2011

/s/ Daniel Buron

Daniel Buron

Senior Vice-President and Chief Financial Officer

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

The undersigned hereby certifies that to his knowledge, the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2011 (the "Form 10-Q") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John D. Williams

John D. Williams

President and Chief Executive Officer

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

The undersigned hereby certifies that to his knowledge, the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2011 (the "Form 10-Q") fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Daniel Buron

Daniel Buron

Senior Vice-President and Chief Financial Officer