NUWAY MEDICAL INC
Form 10QSB
May 15, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

|X| QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2006

or

|_| TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to ______________

Commission File Number 000-19709

NUWAY MEDICAL, INC.
(Exact name of registrant as specified in its charter)

Delaware	65-0159115
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2603 Main Street, Suite 1155
Irvine, California 92614
(Address, including zip code, of principal executive offices)

(949) 235-8062
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: None
Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, $0.0067 par value.

Check whether the Registrant (1) 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 |x| No | |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes |X| No |_|

The number of shares of the Registrant's Common Stock outstanding as of May 11, 2006 was 62,453,501 shares.

DOCUMENTS INCORPORATED BY REFERENCE: None

Transitional Small Business Disclosure Format (Check one): Yes |_| No |X|

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PART I

PART I

Item 1. Financial Statements

NUWAY MEDICAL, INC AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
AS OF MARCH 31, 2006 AND DECEMBER 31, 2005

ASSETS

	March 31, 2006 (unaudited)	Dec
CURRENT ASSETS		
Cash and Cash Equivalents	$ 647,037	$
Prepaid Expenses	63,750	
Total Current Assets	710,787	
TOTAL ASSETS	$ 710,787	$

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

CURRENT LIABILITIES		
Accounts Payable and Accrued Expenses	$ 2,404,126	$
Notes Payable	3,518,070	
Debentures Payable, Net	21,151	
Total Current Liabilities	5,943,347	

COMMITMENTS, CONTINGENCIES AND SUBSEQUENT EVENTS		
SHAREHOLDERS' DEFICIENCY		
Convertible Preferred Series A, $.00067 Par Value, 25,000,000 Shares Authorized, 439,322 and 559,322 Shares Issued and Outstanding at March 31, 2006 and December 31, 2005, respectively	295	
Common Stock, $.00067 Par Value, 100,000,000 Shares Authorized, 62,453,501 and 62,333,501 Shares Issued At March 31, 2006 and December 31, 2005, respectively	41,096	
Additional Paid-In Capital	23,396,874	2
Accumulated Deficit	(28,670,825)	(2
Total Shareholders' Deficiency	(5,232,560)	(
TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIENCY	$ 710,787	$

See accompanying notes to unaudited consolidated financial statements.

NUWAY MEDICAL, INC AND SUBSIDIARY
STATEMENTS OF OPERATIONS FOR THE THREE MONTH PERIOD ENDING
MARCH 31, 2006 AND 2005

	For the period ending March 31 2006 (unaudited)	2005 (unaudited)
Revenue		
Total Revenues	--	--
Costs and Expenses		
Selling, General and Administrative	353,477	193,712
Depreciation, Depletion and Amortization	--	--
Total Costs and Expenses	353,477	193,712
Loss from operations	(353,477)	(193,712)
Other Income and Expense		
Interest Expense	(88,161)	(50,317)
Other Income	--	--
Net Other Expense	(88,161)	(50,317)
Loss Before Income Taxes	(441,638)	(244,029)

Provision for Income Taxes (Benefit)	--	--
Net Loss	(441,638)	(244,029)
Loss Per Common Share - Basic and Diluted		
Loss per share from Continuing Operations	$ (0.01)	$ (0.01)
Net Loss per Share, rounding	$ (0.01)	$ (0.01)
Weighted Average Common Share Equivalents Outstanding	62,453,501	45,786,842

See accompanying notes to unaudited consolidated financial statements.

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NUWAY MEDICAL, INC AND SUBSIDIARY
STATEMENTS OF STOCKHOLDERS' DEFICIENCY (UNAUDITED)
FOR THE THREE MONTH PERIOD ENDING MARCH 31, 2006

	Preferred Stock		Common Stock	
	Number of Shares	Par Value $.00067	Number of Shares	Par Value $.00067
BALANCE DECEMBER 31, 2005	559,322	375	62,333,501	$ 41,016
CONVERSION OF PREFERRED TO COMMON STOCK	(120,000)	(80)	120,000	80
NET LOSS				
BALANCE MARCH 31, 2006	439,322	$ 295	62,453,501	$ 41,096

See accompanying notes to unaudited consolidated financial statements.

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NUWAY MEDICAL, INC AND SUBSIDIARY
STATEMENTS OF CASH FLOWS FOR THE THREE MONTH PERIOD ENDING
MARCH 31, 2006 AND 2005

Three Month Per

	Ending March	
	2006 (unaudited)	20 (unau
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	$(441,638)	$(24
Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities:		
Increase (decrease) in Prepaid Expenses	(63,750)	
Increase in Accounts Payable and Accrued Expenses	91,463	9
Net Cash Used In Operating Activities	(413,925)	(15
CASH FLOWS USED IN INVESTING ACTIVITIES		
No Cash Used In or Provided by Investing Activities	--	
CASH FLOWS FROM FINANCING ACTIVITIES		
Funds from Loans	777,500	15
Payments to reduce Note Payable	--	
Proceeds from Sale of Common Stock	--	
Net Cash Provided By Financing Activities	777,500	15
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	363,575	
CASH AND CASH EQUIVALENTS - BEGINNING	283,462	
CASH AND CASH EQUIVALENTS - ENDING	$ 647,037	$
SUPPLEMENTAL DISCLOSURES OF CASHFLOW INFORMATION		
Cash Paid During the Period for:		
Interest	$ --	$
Income Taxes	$ --	$
Conversion of Debentures and Accrued Interest to Capital	$ --	$

See accompanying notes to unaudited consolidated financial statements.

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NUWAY MEDICAL INC. AND SUBSIDIARY
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1. Accounting Policies-Basis of Presentation

In the opinion of management, the accompanying balance sheets and related interim statements of operations, cash flows, and stockholders' equity include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Actual results and outcomes may differ from management's estimates and assumptions. Estimates are used when accounting for stock-based transactions, uncollectible accounts receivable, asset depreciation and amortization, and taxes, among others.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-QSB should be read in conjunction with Management's Discussion and Analysis and financial statements and notes thereto included in the NuWay Medical, Inc. Annual Report on Form 10-KSB for the year ended December 31, 2005.

Note 2. Business and Organization

Outlook

The Company had no continuing business operations as of March 31, 2006. The Company operated as a public shell during the three month period ended March 31, 2006, and operations primarily consisted of the Company's president seeking funding, maintaining the corporate entity, complying with the requirements of the Securities Exchange Commission (the "SEC") and seeking merger and acquisition candidates or new business opportunities. See discussion of the letter of intent with IOWC Technologies, Inc. ("IOWC"), in Note 5.

The Company will need working capital resources to maintain the Company's status and to fund other anticipated costs and expenses during the year ending December 31, 2006 and beyond, as well as to consummate the transactions with IOWC and fund the operations of the Company after the transactions are consummated. The Company's ability to continue as a going concern is dependent on the Company's ability to raise capital to, at a minimum, meet its corporate maintenance requirements. If the Company is able to acquire IOWC or another ongoing business and/or technology that must be exploited, it would need additional capital until and unless that prospective operation is able to generate positive working capital sufficient to fund the Company's cash flow requirements from operations.

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NUWAY MEDICAL INC. AND SUBSIDIARY
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

Cash and cash equivalents totaled $647,037 at March 31, 2006. The Company had no revenues in the three-month period ended March 31, 2006 and was forced to consume cash on hand to fund operations. The Company will be required to raise additional capital to sustain basic operations through the remainder of 2006 and to consummate the transactions with IOWC. While the Company is actively seeking investments through private investors and other parties, there is no assurance that the Company will be able to raise additional capital for the entire period required.

The Company has approximately $2,740,570 aggregate principal amount of its promissory notes that mature at various times during 2006. The Company does not presently have funds sufficient to repay these obligations as they mature. Even though the terms of all of these notes permit the noteholder to convert the notes into shares of our common stock, until the Company's stockholders approve an amendment to the Company's charter to increase the number of authorized shares of common stock, the Company will be unable to fulfill its obligations to all noteholders to permit the conversion into common stock of amounts due pursuant to the terms of the notes. In the event that the Company has not raised further capital prior to the maturity dates of the convertible notes, the Company would be in default of those notes if its stockholders have not formally approved an increase in the number of authorized common shares, or unless the Company is able to refinance or renegotiate the terms of these notes. No financing is in place at present, and it is unknown if any financing will be in place in the future, which would permit the Company to repay these notes in full as they mature.

The financial statements accompanying this Annual Report have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying financial statements, the Company had a net loss of $441,638 for the three-month period ended March 31, 2006, negative cash flow from operating activities of $413,925 for the three-month period ended March 31, 2006, and an accumulated deficit of $28,670,825 as of March 31, 2006. Also, as of March 31, 2006, the Company had limited liquid and capital resources. The foregoing factors raise substantial doubt about the Company's ability to continue as a going concern. Ultimately, the Company's ability to continue as a going concern is dependent upon its ability to attract new sources of capital, establish an acquisition or reverse merger candidate with continuing operations, such as IOWC, attain a reasonable threshold of operating efficiencies and achieve profitable operations. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

NUWAY MEDICAL INC. AND SUBSIDIARY
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

Organization

The Company was initially organized as Repossession Auction, Inc. under the laws of the State of Florida in 1989. In 1991, the Company merged into a Delaware corporation bearing the same name. In 1994, the Company's name was changed to Latin American Casinos, Inc. to reflect its focus on the gaming and casino business in South and Central America, and in 2001 the Company changed its name to NuWay Energy, Inc. to reflect its new emphasis on the oil and gas development industry. During October 2002, the Company's name was changed to NuWay Medical, Inc. coincident with the divestiture of its non-medical assets and the retention of new management.

Note 3. Due to President - Unreimbursed business expenses

In 2003 and 2004 the Company's President, Dennis Calvert, loaned money to the Company by paying from his personal funds certain of the Company's expenses. A significant portion of these personal funds were obtained by Mr. Calvert by refinancing his primary residence and cashing out equity thereon. On March 7, 2005, the Company and Mr. Calvert agreed such that the $101,770 still outstanding and owed by the Company to Mr. Calvert will be repaid under the terms of a promissory note bearing interest of 10% per annum, requiring monthly payments and maturing on January 15, 2006. The outstanding loan balance was paid off entirely in January of 2006 and totals zero as of March 31, 2006.

As of March 31, 2006, the Company had accrued an expense related to the unpaid accrued compensation due its president, Mr. Calvert, in the amount of $333,664.

Note 4. Sale of Unregistered Securities

First Offering

In January 2005, pursuant to a private offering that commenced in October 2004 and terminated in January 2005 (the "First Offering"), the Company received gross and net proceeds of $25,000 from an outside investor and issued its convertible promissory note (the "First Offering Note") due and payable one year from the date of issuance. The First Offering Note bears interest at a rate of 10% per annum, payable on the maturity date. The First Offering Note can be converted, in whole or in part, into shares of the Company's Series A Preferred stock, on the basis of $.005 per share, at any time prior to maturity by either the Company or the lender. Each share of Series A Preferred Stock may be converted by the holder into one share of the Company's common stock. If the noteholder converts the First Offering Note into Series A Preferred Stock, on or after the note's original maturity date the noteholder may require the Company

to buy back the shares of Series A Preferred Stock for 110% of the principal amount of the note (the "Buy Back Provision"). If the Company is unable to do so, the Company's president, Dennis Calvert, has agreed to buy back the shares on the same terms. If shares of Series A Preferred Stock are converted into common stock, the holder has the right to include (piggyback) the shares of common stock in a registration of securities filed by the Company, other than on Form S-4 or Form S-8.

The Company's payment obligations under the First Offering Note may be accelerated upon the following events: (i) the sale of the Company's assets outside the ordinary course of business; (ii) a breach of the representations and warranties contained within the evidencing the loan; (iii) the failure to timely pay the note; (iv) the Company's default in any other loan obligation greater than $100,000; (v) the Company's dissolution, liquidation, merger, consolidation, bankruptcy, or future insolvency; and (vi) the commencement of any suit that threatens to have a material adverse effect on the Company, including the entry of a final judgment or settlement in excess of $100,000.

Second Offering

In January 2005, pursuant to a private offering that commenced in that month and terminated in August 2005 (the "Second Offering"), the Company received gross and net proceeds of $75,000 from two outside investors and issued its convertible promissory note (the "Second Offering Note") due and payable one year from the date of issuance. The Second Offering Note bears interest at a rate of 10% per annum, payable on the maturity date. The Second Offering Note can be converted, in whole or in part, into shares of the Company's common stock, on the basis ranging from $.005 to $0.016 per share, at any time prior to maturity by either the Company or the holder. The holder has the right to include (piggyback) the shares of common stock in a registration of securities filed by the Company, other than on Form S-4 or Form S-8.

The Company's payment obligations under the Second Offering Note may be accelerated upon the following events: (i) the sale of the Company's assets outside the ordinary course of business; (ii) a breach of the representations and warranties contained within the evidencing the loan; (iii) the failure to timely pay the note; (iv) the Company's default in any other loan obligation greater than $100,000; (v) the Company's dissolution, liquidation, merger, consolidation, bankruptcy, or future insolvency; and (vi) the commencement of any suit that threatens to have a material adverse effect on the Company, including the entry of a final judgment or settlement in excess of $100,000.

In February 2005, the Company received gross proceeds of $51,000 and net proceeds of $47,000 from four outside investors and issued Second Offering Notes which allow conversion into an aggregate total of 5,558,036 shares of common stock (at a conversion price of approximately $0.009 per common share).

In April 2005, the Company received gross proceeds of $29,000 and net proceeds of $23,750 from two outside investors and issued Second Offering Notes which allow conversion into an aggregate total of 2,500,000 shares of common stock (at a conversion price of approximately $0.009 per common share).

In May 2005, the Company received gross and net proceeds of $50,000 and $47,500 from an outside investor and issued a Second Offering Note which allows conversion into a total of 7,142,857 shares of common stock (at a conversion price of $0.007 per common share).

In June 2005, the Company received gross and net proceeds of $256,120 from eleven outside investors and issued Second Offering Notes which allow conversion into an aggregate total of 28,612,000 shares of common stock (at a weighted average conversion price of approximately $0.009 per common share).

Also in July 2005, the Company received gross proceeds of $10,000 and net proceeds of $9,500 from an outside investor and issued a Second Offering Note which allows conversion into an aggregate total of 625,000 shares of common stock (at a conversion price of $0.016 per common share).

In August 2005, the Company received gross proceeds of $260,000 and net proceeds of $252,000 from five outside investors and issued Second Offering Notes which allow conversion into an aggregate total of 16,250,000 shares of common stock (at a conversion price of $0.016 per common share).

Third Offering

Pursuant to another private offering that commenced in September 2005 and terminated in February 2006, on December 31, 2005, the Company sold an aggregate amount of $299,500 of its promissory notes (the "Third Offering Notes") due and payable January 31, 2007 to twelve individual investors. Each Third Offering Note bears interest at a rate of 10% per annum, and can be converted, in whole or in part, into shares of the common stock of the Company at an initial conversion price of $0.025 per share. The Third Offering terminated on February 21, 2006, by which date the Company had raised $1,102,000 gross and net proceeds. Of this amount, $802,500 gross and net proceeds were raised during the three-month period ended March 31, 2006, and the balance had been raised during 2005.

The Third Offering Notes may not be converted by either the Company or the holder unless and until each of the following events has first occurred: (i) the Company's stockholders have approved an increase in the number of shares of common stock authorized by the Company's Certificate of Incorporation in an amount not less than the amount required to permit all notes and warrants issued in this series to be converted into shares of the Company's Common Stock as provided herein, at a validly held meeting of stockholders at which a quorum is

NUWAY MEDICAL INC. AND SUBSIDIARY
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

present and acting throughout; and (ii) the Company has filed with the Secretary of State of State of Delaware a Certificate of Amendment to the Company's Certificate of Incorporation to amend its Certificate of Incorporation to increase the number of shares of common stock authorized by the Company's Certificate of Incorporation.

Purchasers of the Third Offering Notes received, for no additional consideration, a stock purchase warrant (the "Third Offering Warrant") entitling the holder to purchase a number of Shares of Common Stock equal to the number of Shares of Common Stock into which the Third Offering Note is convertible. The Third Offering Warrant is exercisable at an initial price of $0.05 per Share and will expire on January 31, 2008.

Other Issuances

In March 2006, the Company issued 120,000 shares of common stock in connection with the conversion, at the request of one stockholder, of 120,000 shares of convertible preferred stock. All of these offerings and sales were made in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act and/or Regulation D promulgated thereunder as not involving a public offering of securities.

Until the Company's stockholders approve an amendment to the Company's charter to increase the number of authorized shares of common stock, the Company will be unable to fulfill its obligations to all convertible noteholders to permit the conversion into common stock of amounts due pursuant to the terms of the convertible notes. In the event that the Company has not raised further capital prior to the maturity dates of the convertible notes, the Company would be in default of those notes if its stockholders have not formally approved an increase in the number of authorized common shares. The Company is not, at this time, in default of the convertible notes

NUWAY MEDICAL INC. AND SUBSIDIARY
NOTES TO CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

Note 5. Execution of Letter of Intent

On July 25, 2005, the Company and IOWC Technologies, Inc. ("IOWC") signed a binding letter of intent pursuant to which the Company will acquire certain assets, including intellectual property, from IOWC, and IOWC will receive approximately 51% of the issued and outstanding stock of the Company on an after-issued basis. Given the numerous significant conditions which must be satisfied prior to the closing of the transactions, there can be no assurance that the transactions will be consummated as presently envisioned.

Note 6. Extension of Augustine Loan

On July 29, 2005, the Company and the Augustine Fund finalized the terms of an amendment to the Augustine Loan and executed formal documentation, in which the parties agreed to further extend the maturity date to May 2006. In exchange, the Company issued a warrant that gives the Augustine Fund the right to purchase 8,000,000 shares of the Company's common stock at $0.005 per share for a period of five years.

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Item 2. Management's Discussion and Analysis

This Quarterly Report on Form 10-QSB of NuWay Medical, Inc. (the "Company") contains forward-looking statements. These forward-looking statements include predictions regarding, among other things, our:

- business and acquisition plans, including the completion of previously-announced transactions;
- financing plans;
- general and administrative expenses;
- liquidity and sufficiency of existing cash; and
- the outcome of pending or threatened litigation.

You can identify these and other forward-looking statements by the use of words such as "may," "will," "expects," "anticipates," "believes," "estimates," "continues," or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Such statements, which include statements concerning future revenue sources and concentrations, selling, general and administrative expenses, research and development expenses, capital resources, additional financings and additional losses, are subject to risks and uncertainties, including, but not limited to, those discussed elsewhere in this Form 10-QSB, that could actual results to differ materially from those projected.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below under the heading "Risk Factors" in our Annual Report on Form 10-KSB for the year ended December 31, 2005. All forward-looking statements included in this document are based on information available to us on the date hereof. We assume no obligation to update any forward-looking statements.

Unless otherwise expressly stated herein, all statements, including forward-looking statements, set forth in this Form 10-QSB are as of March 31, 2006, and we undertake no duty to update this information.

Overview

The Company had no continuing business operations as of March 31, 2006. The Company operated as a shell company during the three-month period ended March 31, 2006, and operations primarily consisted of the Company seeking funding, maintaining the corporate entity, complying with the reporting and other requirements of the Securities Exchange Commission (the "SEC"), engaging in initial marketing activities for the BioLargo Technology (as defined below), and planning for the consummation of certain proposed transactions, as described below.

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On July 25, 2005, the Company executed a letter of intent ("LOI") with IOWC Technologies, Inc. ("IOWC"), pursuant to which the Company will acquire certain of BioLargo's assets (the "Purchased Assets"), consisting of certain intellectual property, including two United States patents (collectively, the

"BioLargo Technology"), and two license and/or distributor agreements pursuant to which IOWC has licensed the BioLargo Technology for use in products designed for distribution in the food, medical and biohazardous material transportation industries. All assets not constituting the Purchased Assets will remain the property of BioLargo following the closing. The Company will not assume any liabilities of BioLargo.

The parties also agreed that on or prior to the closing, they would enter into a definitive asset purchase agreement (the "Asset Purchase Agreement"), and other agreements, including a research and development agreement (the "R&D Agreement"), to effect the transactions (the "Transactions") on or prior to the closing. Pursuant to the R&D Agreement, the Company will pay BioLargo a monthly fee to conduct research to further develop the existing BioLargo Technology and products based on the existing and new technologies.

The LOI also requires the Company to raise sufficient funds to (i) cover the costs of the transactions, (ii) three months post-closing operating expenses, the latter of which is estimated at approximately $300,000 and (iii) provide interim funding to BioLargo on a best efforts basis and in amounts agreed between the parties in an aggregate amount not to exceed $1,000,000.

The LOI further provides that, at the Closing, the Company and Dennis Calvert, the President and CEO of the Company, will enter into an employment agreement for a term of five years, providing Mr. Calvert with a monthly salary of $15,400 for 2006, and a 10% increase in his monthly salary for each calendar year thereafter.

It is anticipated that the present management of the Company will remain in place after the closing and that Mr. Code will become the Company's Chief Technology Officer. In connection therewith, Mr. Code will enter into an employment agreement with the Company (the "Code Employment Agreement").

In connection with the previously described transactions and in partial implementation thereof, on December 31, 2005, the Company executed a Marketing and Licensing Agreement (the "M&L Agreement") with BioLargo. Pursuant to the M&L Agreement, the Company, through its wholly-owned subsidiary BioLargo Life Technologies, Inc., a California corporation ("BLTI"), has the right ("Rights") to develop, market, sell and distribute products that were developed, and are in development, by BioLargo using the BioLargo Technology.

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BioLargo also assigned to BLTI its rights and obligations under two license agreements, including BioLargo, LLC, in which BioLargo has a 20% interest, as well as its rights set forth in a LOI with another entity (collectively, the "Assigned Agreements").

The M&L Agreement provides that the Company is to receive any and all royalties, payments, license fees, and other consideration generated by the Assigned Agreements. As part of the M&L Agreement, IOWC has agreed to transfer its 20% interest in BioLargo, LLC to the Company. In consideration of the Rights and the Assigned Agreements, the Company has agreed to issue IOWC a total of 38% of its common stock.

The parties further agreed to enter into additional agreements in furtherance of the July 2005 LOI between the Company and IOWC, including (i) the Asset Purchase Agreement, whereby the Company would acquire the two U.S. patents held by IOWC; (ii) the R&D Agreement, with a company to be managed and controlled by Mr. Code; and (iii) the Code Employment Agreement. In consideration of the Asset Purchase Agreement, the Company has agreed to issue IOWC an additional one percent of its common stock. In consideration of the R&D

Agreement and Code Employment Agreement, the Company has agreed to issue to Code individually 17.6% of its common stock. As a result of the foregoing transactions, the Company will issue a total of 56.6% of its common stock to BioLargo, calculated on January 1, 2006. The parties further agreed that to the extent that the Company issues additional equity in connection with one or more financing transactions after January 1, 2006, then the percentage of equity to be issued to BioLargo would be diluted pro rata.

The Code Employment Agreement is anticipated to provide that Mr. Code will be appointed Chief Technology Officer of BLTI, and receive a monthly salary of $15,400. As explained below, the Company is required to obtain the approval of its stockholders prior to the issuance of the common stock to IOWC required pursuant to the M&L Agreement.

The foregoing transactions are subject to approval by IOWC's board of directors and stockholders, approval by the Company's board of directors, and approval by the Company's stockholders of the following matters:

- an amendment to the Company's Certificate of Incorporation increasing the number of authorized shares of its common stock;

- the issuance of the number of shares of common stock to IOWC required pursuant to the Transactions;

- a reverse split of the Company's common stock; and

- the election of Mr. Code to the Company's board of directors.

In the event that the Company's stockholders do not approve the issuance of stock, the M&L Agreement shall terminate, and all rights granted to the Company shall revert to BioLargo.

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The closing of the transactions is subject to various conditions, including those described hereinabove, and conditions customary for transactions of this nature. The Company currently expects to close the transactions in the fourth quarter of 2006. However, given the numerous significant conditions which must be satisfied prior to the closing of the transactions, there can be no assurance that the transactions will be consummated as presently envisioned or at all.

The Company will need working capital resources to maintain the Company's status and to fund other anticipated costs and expenses during the year ending December 31, 2006 and beyond, including its obligations to IOWC. The Company's ability to continue as a going concern and to consummate the transactions with IOWC is dependent on the Company's ability to raise capital. If the Company is able to acquire IOWC, it will need additional capital until and unless that prospective operation is able to generate positive working capital sufficient to fund the Company's cash flow requirements from operations. The Company has commenced an offering of its convertible notes and warrants to provide such interim funding. See "Liquidity and Capital Resources" below.

Results of Operations

Revenue. The Company had no revenues from continuing operations during the three-month periods ended March 31, 2006 and 2005.

Selling, general and administrative expenses. Selling, general and administrative were $353,000 for the three-month period ended March 31, 2006, compared to $194,000 for the three-month period ended March 31, 2005. This increase is primarily attributable to the increase in consulting and legal expenses in the three-month period ended March 31, 2006 compared with the same period in 2005. The largest components of these expenses were:

The largest components of these expenses were:

a. Salaries and Payroll-Related Expenses: These expenses were $46,000 for the three-month period ended March 31, 2006, compared to $49,000 for the three-month period ended March 31, 2005, a decrease of $3,000.

b. Consulting Expenses: These expenses were $152,000 for the three-month period ended March 31, 2006, compared to $41,000 for the three-month period ended March 31, 2005, an increase of $111,000. The increase in the three-month period ended March 31, 2006 is attributable to the increase in the Company's need for outside consultants during that time.

c. Legal Expenses: These expenses were $87,000 for the three-month period ended March 31, 2006, compared to $51,000 for the three-month period ended March 31, 2005, an increase of $36,000. This increase is primarily due to the high level of legal services required during the three-month period ended March 31, 2006 with respect to the ongoing business relationship with IOWC.

d. Independent Director Compensation: These expenses were $15,000 for the three-month period ended March 31, 2006, compared to $1,000 for the three-month period ended March 31, 2005, an increase of $14,000.

Net Loss. Net loss for the three-month period ended March 31, 2006 was $442,000, or $(0.01) per share. Comparatively, for the three-month period ended March 31, 2005, net loss was $244,000, or $(0.01) per share.

Liquidity and Capital Resources

General

Cash and cash equivalents totaled $647,037 at March 31, 2006. The Company had no revenues in the three-month period ended March 31, 2006 and was forced to consume cash on hand to fund operations. The Company's cash position is insufficient to meet its expenses or its obligations under the LOI with IOWC to acquire the BioLargo Technology. The Company will be required to raise additional capital to sustain basic operations through the remainder of 2006 and to consummate the transactions with IOWC.

The financial statements accompanying this Report have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. The Company had a net loss of $441,638 for the three-month period ended March 31, 2006; a negative cash flow from operating activities of $413,925 for the three-month period ended March 31, 2006; and an accumulated deficit of $28,229,187 as of December 31, 2005, and $28,670,825 as of March 31, 2006.

As of March 31, 2006, the Company had limited liquid and capital resources although it is seeking acquisition opportunities. These factors raise substantial doubt about the Company's ability to continue as a going concern. Ultimately, the Company's ability to continue as a going concern is dependent upon its ability to attract new sources of capital, establish an acquisition or reverse merger candidate with continuing operations, such as IOWC, attain a reasonable threshold of operating efficiencies and achieve profitable operations. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

The Company has approximately $2,740,570 aggregate principal amount of its promissory notes that mature at various times during 2006. The Company does not presently have funds sufficient to repay these obligations as they mature. Even though the terms of all of these notes permit the noteholder to convert the notes into shares of our common stock, until the Company's stockholders approve an amendment to the Company's charter to increase the number of authorized shares of common stock, the Company will be unable to fulfill its obligations to all noteholders to permit the conversion into common stock of amounts due pursuant to the terms of the notes. In the event that the Company has not raised further capital prior to the maturity dates of the convertible notes, the Company would be in default of those notes if its stockholders have not formally approved an increase in the number of authorized common shares, or unless the Company is able to refinance or renegotiate the terms of these notes. No financing is in place at present, and it is unknown if any financing will be in place in the future, which would permit the Company to repay these notes in full as they mature.

The Company has obtained the consent of all of its noteholders to extend the maturity date of those convertible notes maturing on various dates through November 2006, until after the Company has held a stockholders' meeting, currently anticipated for the fourth quarter of 2006, to approve, among other things, an increase in the authorized capital stock of the Company and thereby permit the conversion of such notes into shares of the Company's common stock.

Pursuant to a private offering that commenced in September 2005 and terminated in February 2006, the Company offered up to $2,000,000 of its convertible notes (the "Third Offering Notes"), which are due and payable on January 31, 2007. The Third Offering Notes bear interest at a rate of 10% per annum, payable on the maturity date, and can be converted, in whole or in part, into shares of the Company's common stock, on a basis of $0.025 per common share, at any time prior to maturity by either the Company or the holder. Purchasers of the Third Offering Notes will receive, for no additional consideration, a stock purchase warrant (a "Third Offering Warrant") entitling the holder to purchase a number of shares of Common Stock equal to the number of shares of Common Stock into which the Third Offering Note is convertible, at an initial price of $0.05 per share, with an expiration of January 31, 2008. The offering terminated on February 21, 2006, by which date the Company had raised $1,102,000 gross and net proceeds. Of this amount, $802,500 gross and net proceeds were raised during the three-month period ended March 31, 2006, and the balance had been raised during 2005. See Part II, Item 2, "Sales of Unregistered Securities".

The Company will be required to raise additional capital during 2006 to sustain its operations and meet its liabilities as they become due for the next twelve months, as well as to consummate the transactions with IOWC and fund the operations of the Company after the transactions are consummated. While the Company is actively considering investment alternatives for the Company's longer-term financial requirements, there is no assurance that the Company will be able to raise any additional capital. It is unlikely that the Company will be able to qualify for bank debt until such time as the Company is able to demonstrate the financial strength to provide confidence for a lender.

Significant debt obligations of the Company at March 31, 2006 included:

(i) $420,000 due to Augustine II, LLC (the "Augustine Fund"), together with accrued but unpaid interest, described in more detail below;

(ii) a $1,120,000 note payable which was purchased in March 2003 by New

Millennium Capital Partners, LLC ("New Millennium"), an entity owned and controlled by the Company's president, Dennis Calvert, and certain members of his family, together with accrued but unpaid interest, described in more detail below;

(iii) amounts owed to Mr. Calvert personally in the aggregate amount of approximately $334,000, as described below;

(iv) convertible promissory notes to various investors in the aggregate principal amount of $816,000, plus accrued interest;

(v) approximately $21,000 outstanding remaining on a settlement agreement with former convertible debenture holders; and

(vi) $35,000 in remaining balance due to a former advisory board member, from a promissory note dated November 20, 2003 in the original principal amount of $65,000.

For the three-month period ended March 31, 2006, there was $667,000 of accrued interest recorded related to these obligations.

Augustine Fund Note

On June 10, 2003 the Company entered into a Term Loan Agreement ("Loan Agreement") with the Augustine Fund, pursuant to which the Augustine Fund agreed to lend the Company $420,000, payable in installments of $250,000, $100,000, and $70,000 (the "Augustine Loan"). The proceeds of the Augustine Loan were used by the Company for working capital.

Principal and interest, at an annual rate of 10%, of the Augustine Loan, was originally due on February 29, 2004. In addition, the Loan Agreement contains certain requirements that the Company make mandatory prepayments of the Augustine Loan from the proceeds of any asset sales outside of the ordinary course of business, and, on a quarterly basis, from positive cash flow. In addition, all or any portion of the Augustine Loan may be prepaid by the Company may prepay all or any portion of the Augustine Loan at any time without premium or penalty.

As additional consideration for making the Augustine Loan, the Augustine Fund received five-year warrants to purchase up to 6,158,381 shares of the Company's common stock at an exercise price of $0.16 per share. The Company could require that the warrants be exercised if certain conditions were satisfied. Since these conditions were not fully satisfied by the maturity date, the Loan Agreement provides that the Augustine Fund may, at any time following the maturity date and so long as the warrants remain exercisable, elect to exercise all or any portion of the warrants pursuant to a "cashless exercise", whereby the Augustine Fund would be issued the net amount of shares of our common stock, taking into consideration the difference between the exercise price of the warrants and the fair market value of our common stock at the time of exercise, without having to pay anything to the Company for such exercise.

As security for the Augustine Loan, New Millennium Capital Partners LLC ("New Millennium"), a company controlled and owned by the Company's president, Dennis Calvert, and members of his family, pledged 2.5 million shares of the Company's common stock owned by New Millennium, and, in addition, the Company has granted the Augustine Fund a security interest in its 51% membership ownership interest in NuWay Sports. As a result, the Company will need to consent of the Augustine Fund to release its security interest in NuWay Sports if the Company is able to sell NuWay Sports.

Prior to the original maturity date of the Augustine Loan, the Company spoke with representatives of the Augustine Fund and advised them that the Company was unable to pay the amount due under the Augustine Loan by the February 29, 2004 maturity date. On March 30, 2004, the Augustine Fund agreed to extend the maturity date of the Loan Agreement to August 2004. In addition to the extension of the maturity date, the Augustine Fund was given the option of having the Augustine Loan satisfied in cash or by the conversion of any remaining principal balance and any accrued interest on the Augustine Loan to shares of the Company's common stock at a 15% discount to market, so long as Augustine Fund's holdings do not exceed 4.9% of the total issued and outstanding shares of the Company's common stock at any time. In addition, the warrants held by the Augustine Fund to purchase 6,158,381 shares of the Company's common stock were re-priced to an exercise price of $.035 per share. Exercise of the warrants is also subject to the limit that the Augustine Fund does not hold more than 4.9% of the issued and outstanding shares of the Company's common stock.

On July 29, 2005, the Company and the Augustine Fund finalized the terms of an amendment to the Augustine Loan and executed formal documentation, in which the parties agreed to further extend the maturity date to May 2006. In exchange, the Company issued a warrant that gives the Augustine Fund the right to purchase 8,000,000 shares of the Company's common stock at $0.005 per share for a period of five years. Accordingly, as of March 31, 2006, the principal amount of the loan, together with approximately $183,209 in accrued but unpaid interest, had not been repaid.

Obligation to New Millennium

In conjunction with the acquisition from Med Wireless of the license for the its technology in 2002, the Company assumed a $1,120,000 note (the "Note") with interest at 10% per annum payable by Med Wireless to Summitt Ventures, Inc. ("Summitt Ventures"). The Note is secured by the Company's assets and was originally due on June 15, 2003. It was sold, as part of a series of transactions with Mark Anderson, a former consultant and former principle stockholder of the Company, and his affiliated entities, to New Millennium, an entity owned and controlled by the Company's president, Dennis Calvert, and certain members of his family, in March 2003.

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Since New Millennium purchased the Note, the Company has attempted multiple times to convert the Note, but has been unable to obtain the required stockholder vote, due to a lack of quorum, to do so. New Millennium orally agreed with the Company to extend the maturity date of the Note to a first payment due October 1, 2003 in the amount of $100,000 and the balance of the principal due on April 1, 2004. The Company was unable to make the $100,000 payment on the Note on the extended due date of October 1, 2003.

In October 2004, New Millennium agreed to extend the maturity of the Note indefinitely until the Company acquired assets or an operating business that would allow it to meet its obligations on the note. Accordingly, as of March 31, 2006, the principal amount of the loan, together with approximately $345,954 in accrued but unpaid interest, had not been repaid.

Under the terms of the New Millennium Note, it is possible that Summitt Ventures, and Mr. Anderson's affiliated entities may have a claim to reacquire the shares of the Company's common stock that were sold to New Millennium. The New Millennium Note is purportedly secured by the purchased shares of the

Company's common stock; however, New Millennium and Mr. Calvert believe that Mr. Anderson and his affiliates have not perfected their security interest in those shares. In addition, the Augustine Fund is the pledgee of 2,500,000 of those shares and has physical possession of those shares.

On April 28, 2006, the Board and Mr. Calvert agreed to amend the New Millennium Note to (i) extend the due date to January 15, 2008; (ii) waive any payments of interest until the New Millennium Note becomes due; (iii) reduce the principal amount of the New Millennium Note from $1,120,000 to $900,000, equal to a 19.6% reduction, and New Millennium's basis in said Note; and (iv) correspondingly reduce the accrued but unpaid interest due under the terms of the New Millennium Note from $317,956 to $255,636, also equal to a 19.6% reduction.

Obligations to Dennis Calvert

In 2003 and 2004 the Company's President, Dennis Calvert, loaned money to the Company by paying from his personal funds certain of the Company's expenses. A significant portion of these personal funds was obtained by Mr. Calvert by refinancing his primary residence and cashing out equity thereon. On March 7, 2005, the Company and Mr. Calvert agreed such that the $101,770 still outstanding and owed by the Company to Mr. Calvert will be repaid under the terms of a promissory note bearing interest of 10% per annum, requiring monthly payments and maturing on January 15, 2006.

As of March 31, 2006, the Company had repaid this entire loan. As of March 31, 2006, the Company had accrued an expense related to the unpaid accrued compensation due Mr. Calvert in the amount of $333,664.

Critical Accounting Policies

The SEC recently issued Financial Reporting release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggesting companies provide additional disclosure and commentary on their most critical accounting policies. In FRR 60, the SEC defined the most critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and operating results, and require management to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, the Company's most critical accounting policies include: non-cash transactions and compensation valuations that affect the total expenses reported in the current period and/or values of assets received in exchange.

The Company has established a policy relative to the methodology to determine the value assigned to each intangible acquired with or licensed by the Company and/or services or products received for non-cash consideration of the Company's common stock. The value is based on the market price of the Company's common stock issued as consideration, at the date of the agreement of each transaction or when the service is rendered or product is received, as adjusted for applicable discounts.

The methods, estimates and judgments the Company uses in applying these most critical accounting policies have a significant impact on the results of the Company reports in its financial statements.

Item 3. Controls and Procedures

(a) Evaluation of disclosure controls and procedures: Our management evaluated, with the participation of our Chief Executive Officer and Chief

Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-QSB. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

(b) Changes in internal control over financial reporting: There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-QSB that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

Item 1. Legal Proceedings

In June 2002, Geraldine Lyons, the Company's former Chief Financial Officer, sued the Company and the Company's former president Todd Sanders, for breach of her employment contract. The lawsuit was brought in the Circuit Court of the 11th Judicial Circuit in Miami-Dade County in Florida. Ms. Lyons seeks approximately $25,000 due under the contract and the issuance of 100,000 shares of common stock, with a guarantee that the stock could be sold by Ms. Lyons for $300,000. Ms. Lyons alleges that additional funds are due under her employment contract; that the contract requires the Company guarantee that she can sell for $300,000 the 100,000 shares of stock the Company is required to issue her; and, that Mr. Sanders promised to purchase from her 100,000 shares of Company common stock held by her at the price of $4.00 per share.

The Company has counter-sued Ms. Lyons for breach of fiduciary duty, fraud, violation of Section 12(a)(2) of the Securities Act of 1933, violation of Section 517.301 of the Florida Statutes, negligent misrepresentation, conversion and unjust enrichment resulting from the required restatement of the Company's financial statements for the years ended December 31, 2000 and December 31, 1999. The restatements corrected the previous omission of certain material expenses related primarily to compensation expense arising from warrants issued and repriced stock options, as well as other errors.

The case is ongoing at this time, although it has not been vigorously prosecuted by Ms. Lyons or the Company, in the Company's case primarily because the Company had lacked the resources to do so. The Company entered into an agreement ("Legal Defense Agreement") in December 2004 such that Augustine II, LLC ("Augustine Fund") would pay for the legal expenses associated with the Company's defense and affirmative claims in this lawsuit (with the right to withdraw funding at any time), and in exchange would share any net proceeds awarded to the Company pursuant to a settlement or judgment. The sharing arrangement provides that Augustine Fund will recover first, out of any money available from recovery, its legal and out of pocket expenses related to the lawsuit; second, 85% of any additional amounts recovered up to $500,000; and third, 50% of amounts recovered beyond $500,000. While the Company believes that it has meritorious positions in this litigation, given the inherent nature of litigation, it is not possible to predict the outcome of this litigation or the impact it would have on the Company.

In May 2004, the Company was sued by Flight Options, Inc. ("Flight Options"), a jet plane leasing company, in the Superior Court of Orange County California. The lawsuit alleges that the Company owes Flight Options approximately $418,300, pursuant to a five-year lease assigned to the Company by the Company's former president Todd Sanders, from his corporation, Devenshire Management Corporation ("Devenshire"). Management of the Company believes that the assignment of the lease was not properly authorized or approved by the Company, and that by Mr. Sander's failure to identify the lease in a December 2002 settlement agreement with the Company, he breached the terms of that settlement agreement and, pursuant to the settlement agreement, must indemnify the Company for any losses owed to Flight Options. The Company filed a cross-complaint against Mr. Sanders and Devenshire seeking indemnity and alleging Mr. Sander's breached his fiduciary duties in connection with the assignment of the lease. The Company's Legal Defense Agreement with the Augustine Fund applies also to the Flight Options litigation.

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On March 17, 2005, the Company settled with Flight Options pursuant to a stipulation that would have allowed the Company to pay Flight Options $100,000 on or before August 5, 2005; if $100,000 was not paid by August 5, 2005, Flight Options could file a judgment against the Company for $163,310. The Company did not make a payment on or before August 5, 2005. Subsequently, the parties agreed that the Company would pay Flight Options a total of $116,000, which amount was paid. In exchange, Flight Options dismissed the case.

At about the time of the settlement with Flight Options, the Company, Mr. Sanders and Devenshire agreed to submit the matters in the cross-complaint, including the indemnity claim, to binding arbitration. On March 7, 2006, an arbitrator issued a binding award in favor of the Company and against Mr. Sanders for $120,000.

Legal Fees in the matter have been paid by Augustine, pursuant to the Legal Defense Agreement between Augustine and the Company. In January 2006, Augustine and the Company agreed to modify the terms of the Legal Defense Agreement to allow for both parties to share in any amounts which might be recovered from Sanders, on a percentage basis equal to the respective costs incurred by each party. Legal Fees incurred by Augustine are estimated to be approximately $81,000 as of February 2006, but will likely increase.

The Company is party to various other claims, legal actions and complaints arising periodically in the ordinary course of business. In the opinion of management, no such matters will have a material adverse effect on the Company's financial position or results of operations.

Item 2. Changes in Securities

Pursuant to a private offering that commenced in September 2005 and terminated in February 2006, during the three-month period ended March 31, 2006, the Company sold an aggregate principal amount of $802,500 of its Third Offering Notes to 44 individual investors. Each Third Offering Note bears interest at a rate of 10% per annum, and can be converted, in whole or in part, into shares of the common stock of the Company at an initial conversion price of $0.025 per share.

The Third Offering Notes may not be converted by either the Company or the holder unless and until each of the following events has first occurred: (i) the Company's stockholders have approved an increase in the number of shares of common stock authorized by the Company's Certificate of Incorporation in an amount not less than the amount required to permit all notes and warrants issued in this series to be converted into shares of the Company's Common Stock as provided herein, at a validly held meeting of stockholders at which a quorum is present and acting throughout; and (ii) the Company has filed with the Secretary of State of State of Delaware a Certificate of Amendment to the Company's Certificate of Incorporation to amend its Certificate of Incorporation to increase the number of shares of common stock authorized by the Company's Certificate of Incorporation.

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Purchasers of the Third Offering Notes received, for no additional consideration, a Third Offering Warrant entitling the holder to purchase a number of shares of Common Stock equal to the number of shares of Common Stock into which the Third Offering Note is convertible. The Third Offering Warrant is exercisable at an initial price of $0.05 per share and will expire on January 31, 2008.

In March 2006, the Company issued 120,000 shares of common stock in connection with the conversion, at the request of one stockholder, of 120,000 shares of convertible preferred stock.

All of these offerings and sales were made in reliance on the exemption from registration contained in Section 4(2) of the Securities Exchange Act and/or Regulation D promulgated thereunder as not involving a public offering of securities.

Until the Company's stockholders approve an amendment to the Company's charter to increase the number of authorized shares of common stock, the Company will be unable to fulfill its obligations to all convertible noteholders to permit the conversion into common stock of amounts due pursuant to the terms of the Company's various convertible notes. In the event that the Company has not raised further capital prior to the maturity dates of the convertible notes, the Company would be in default of those notes if its stockholders have not formally approved an increase in the number of authorized common shares. The Company is not, at this time, in default of the convertible notes.

Item 6. Exhibits

The exhibits listed below are attached hereto and filed herewith:

Exhibit No.	Description
31.1	Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e).
31.2	Certification of Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350
32	Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e).

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

NUWAY MEDICAL, INC.

Date: May 15, 2006 By: /s/ Dennis Calvert

Dennis Calvert
President, Chief Executive Officer
and Interim Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Description
31.1	Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e).
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32	Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e).

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Catalogs Catalogs Security check papers

envelopes Wallpapers

Capacity *

As at February 28, 2005 approximately 2.7 million tons

0.9 million tons 0.1 million tons 0.6 million tons 0.4 million tons 0.3 million tons 0.4 million tons

33 % 4 % 22% 14 % 13 % 14%

* The allocation of production capacity may vary from year to year in order to take advantage of market conditions. On December 9, 2004, we announced the indefinite closure of the pulp mill, one paper machine and its sheeter at our Cornwall mill until economic and market conditions allow these assets to operate profitably. This indefinite closure, impacting 85,000 tons of paper, has not been reflected in the above capacity.

Our business papers consist mainly of uncoated freesheet papers, such as copy and premium imaging papers used in photocopy machines, laser and inkjet printers. These products are principally for home and office use and represent about 37% of our paper production.

Our commercial printing grade papers include uncoated freesheet papers, such as offset papers, opaques and a variety of coated printing papers. These grades are used in sheet and roll fed offset presses across the spectrum of commercial printing end uses, including digital printing. Our publication papers include tradebook and lightweight uncoated and coated papers used principally in book publishing applications such as textbooks, dictionaries, catalogs, magazines, hard cover novels and financial printing. Design papers, a sub-group of commercial printing and publication papers, have distinct features of color, brightness and texture and are targeted towards graphic artists in design and advertising agencies, for use primarily in special brochures and annual reports. Commercial printing and publication papers represent 49% of our paper production.

We also produce paper for several technical and specialty markets. These technical and specialty papers consist primarily of base stock used by the flexible packaging industry in the production of food and medical packaging and other specialty papers for various other industrial applications, including base stock for sandpaper and wallpaper, base stock for medical gowns, drapes and packaging, as well as transfer paper for printing processes. We also participate in several converting grades for specialty and security applications. These technical and specialty papers represent about 14% of our paper production.

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Product Development

We pursue product development opportunities in order to provide customers with new or enhanced products. We annually target specific improvements for profitability and volume of new product sales. New product ideas are proactively sought and rewarded throughout the organization. Ideas are screened and products developed using the *Stage-Gate* process, which ensures a disciplined approach that prioritizes and plans activities to maximize benefits and minimize development costs and time to market. Technical and specialty papers are often created in partnership with product manufacturers and sold to them directly. Our various manufacturing capabilities provide us with flexibility to develop specialized products at a competitive cost advantage over the life cycle of the products. During 2004, we shipped approximately 180,000 tons of products that were improved/developed after 2001, accounting for about 7% of our total paper shipments. We also support fundamental research at several universities and through research institutions such as the Pulp and Paper Research Institute of Canada.

Customers and Distribution

The following chart illustrates our channels of distribution for our paper products:

Category	**Business Papers**			**Commercial Printing and Publication Papers**		**Technical and Specialty Papers**
Domtar sells to:	Merchants ↓	Office Equipment Manufacturers / Stationers ↓	Retailers ↓	Merchants ↓	Converters ↓	Converters ↓
Customer sells to:	Printers / Retailers / End-users	Retailers / Stationers / End-users	Printers / End-users	Printers / Converters / End-users	Merchants / Retailers	End-users

Generally, we sell business papers through paper merchants and to office equipment manufacturers, stationers and retail outlets. We distribute coated and uncoated commercial printing and publication papers to end-users and commercial printers, mainly through paper merchants, as well as selling directly to converters. We sell our technical and specialty products mainly to converters, who apply a further production process such as coating, laminating or waxing to our papers before selling them to a variety of specialized end-users.

Our customer service personnel work closely with sales, marketing and production staff to provide service and support to merchants, converters, end-users, stationers, printers and retailers. We promote our products directly to end-users and others who influence paper purchasing decisions in order to enhance brand recognition and increase product demand. In addition, our sales representatives work closely with mill-based new product development personnel and undertake joint marketing initiatives with customers in order to better understand our customers businesses and needs and to support their future requirements.

We distributed about 60% of our paper products in 2004 through a large network of paper sales merchants operating throughout North America, one of which we own (see Paper Merchants). Paper merchants, who sell our products to their own customers, represent our largest group of customers.

During 2004, we made approximately 90% of paper sales to customers in the United States.

In connection with the 2001 Acquisition, we signed a distribution agreement with Georgia-Pacific Corporation (GP) to sell up to 748,000 tons of paper, principally printing and imaging, per year to GP and its then wholly-owned subsidiary Unisource Worldwide, Inc. (Unisource). A part of this volume is not subject to firm commitments by GP or Unisource. This contract matures in 2006. In November 2002, part of the distribution agreement was assigned to Unisource in conjunction with the sale of a majority interest in Unisource by GP. GP has agreed to guarantee the performance of Unisource for the portion of the contract which was assigned. We do not view the maturity of this contract as having a material impact on our shipments as we believe that the contracted volume will continue to be sold to Unisource or through other paper merchants.

We sell market pulp to customers in North America through a centrally located sales force. We also sell market pulp to overseas customers through commission agents. We maintain pulp supplies at strategically located warehouses, which allows us to respond to orders on short notice. In 2004, approximately 10% of our sales of market pulp were made in Canada, 41% were made in the United States, 3% in Mexico and 46% overseas. We also purchase pulp to optimize paper production and reduce freight costs. In 2004 our net market pulp position (shipments less purchases) was approximately 700,000 tons.

In order to better respond to customer needs and improve the flexibility of our production network, we are implementing an integrated resource management system. Progressively introduced since July 2003, this system aims to establish a common platform and database for customer service, integrate production-planning processes in the mills and implement common financial processes and standards. As at December 31, 2004, approximately 50% of our transactions were being processed by this system.

Facilities

The quality and breadth of our manufacturing assets allow us to be a low cost producer of high volume papers and an efficient producer of lower volume, value-added specialty papers.

The following table lists the paper production facilities owned and operated by us. The table also indicates the number of paper machines at each facility, the principal products manufactured at each facility, and the approximate annual production capacity of each facility. Over 50% of our paper production capacity is located in the United States. All of our pulp and paper mills are certified ISO 14001 except for our Windsor mill, which is certified under the Responsible Care program. In addition, all of our mills are Forest Stewardship Council (FSC) chain of custody certified except for our Ashdown mill, which we aim to certify by the end of 2006, and our Lebel-sur-Quévillon pulp mill, whose certification was postponed until discrepancies between FSC standards and Quebec legislation are addressed.

Paper Production Facility	**Location**	**Paper Machines**	**Principal Paper Type**	**Annual Capacity(1) (millions of tons)**
Ashdown	Arkansas	4	Copy, offset and technical and specialty	0.9
Windsor	Quebec	2	Copy and offset	0.6
Nekoosa	Wisconsin	3	Uncoated printing and technical and specialty	0.1
Port Edward	Wisconsin	4	Uncoated printing and technical and specialty	0.2
Cornwall	Ontario	3	Uncoated and coated printing	0.3
Ottawa-Hull	Ontario/Quebec	3	Coated lightweight	0.2
Vancouver	British Columbia	1	Coated printing	0.1
Woodland	Maine	1	Copy, offset and technical and specialty	0.1
Port Huron	Michigan	4	Technical and specialty	0.1
Espanola	Ontario	2	Technical and specialty	0.1
Total		27		2.7

(1) Capacity as at February 28, 2005. On December 9, 2004, we announced the indefinite closure of the pulp mill, one paper machine and its sheeter at our Cornwall mill until economic and market conditions allow these assets to operate profitably. This indefinite closure, impacting 85,000 tons of paper, has not been reflected in the above capacity.

Our net market pulp position principally results from production at our mills in Ashdown, Espanola, Lebel-sur-Quévillon, and Woodland.

For a discussion on sources of raw material for paper production, see Fiber Supply section.

Power Facilities

We own power generating facilities at nine locations: Ashdown, Espanola, Lebel-sur-Quévillon, Nekoosa, Port Edwards, Ottawa-Hull, Port Huron, Windsor and Woodland. Approximately 60% of our electric power requirements are met by our own facilities. We purchase the balance of our power requirements from local utilities. In addition, we provide about 68% of the energy required to produce steam internally through our recovery boilers and cogeneration facilities with the remaining energy purchased in the form of bark, natural gas, oil and coal.

Paper Merchants

Our Paper Merchants business comprises the purchasing, warehousing, sale and distribution of various products made by us and by other manufacturers. These products include business and printing papers, graphic arts supplies and certain industrial products. These products are sold to a wide and diverse customer base, which includes small, medium and large commercial printers, publishers, business forms manufacturers, quick copy firms and institutional entities.

Domtar-owned paper merchants operate in the United States and Canada. On November 18, 2004, we announced that we had gathered all our merchant operations under a single banner and umbrella name, the Domtar Distribution Group, thereby creating the fifth largest paper merchant organization in North America. Ris Paper, acquired in July 2000, operates throughout the Northeast, Mid-Atlantic and Mid-West areas from 20 locations in the United States, including 17 distribution centers. The Canadian business operates as Buntin Reid in three locations in Ontario; JBR/La Maison du Papier in two locations in Quebec; and The Paper House in three locations in Atlantic Canada. Our Paper Merchants business represented 21% of consolidated sales in 2004, or 15% when excluding sales of Domtar paper, compared to 21% of consolidated sales in 2003, or 15% when excluding sales of Domtar paper. In 2004, approximately 32% of Paper Merchants sales were made to customers in Canada and 68% were made to customers in the United States.

Sales are executed through our sales force based at branches strategically located in served markets. We distribute about 55% of our paper sales from our own warehouse distribution system and about 45% of our paper sales through mill-direct deliveries (i.e., deliveries directly from manufacturers, including Domtar, to our customers). The branch warehousing capability is configured as a regional hub and spoke operation whereby larger hub branches carry higher and more diverse levels of inventory to support larger local market needs along with inter-branch shipments to smaller spoke branches.

Wood

Our Wood business comprises the manufacturing and marketing of lumber and wood-based value-added products from our operating facilities located in Ontario and Quebec, as well as the management of forest resources in Ontario and Quebec. We also have investments in four businesses that produce wood products. Our Wood business represented 11% of consolidated sales in 2004 compared to 8% of consolidated sales in 2003.

We produce mainly softwood dimensional lumber used primarily in the construction industry. Products include studs and random length lumber in dimensions of 2 inches X 3 inches through 2 inches X 10 inches in lengths of 8 feet to 16 feet. We operate six sawmills and one re-manufacturing facility in Quebec (Matagami, Lebel-sur-Quévillon, Val-d Or, Malartic, Grand-Remous, Ste-Marie and Sullivan) and four sawmills in Ontario (White River, Timmins, Elk Lake (jointly-owned) and Nairn Center, reflecting the permanent closure of the Chapleau sawmill, effective March 6, 2005). As at February 28, 2005, these facilities had a total annual capacity of 1.1 billion board feet of lumber. In 2004, approximately 90% of the lumber shipped by us was kiln dried.

The following table sets forth our trade shipments of lumber for the years indicated:

	Years ended December 31,				
	2004	**2003**	**2002**	**2001**	**2000**
Lumber (millions of board feet)	1,009	999	1,037	982	1,149

We sell substantially all of our softwood lumber through our own sales office in Montreal to a wide range of retailers, distributors, manufacturers and wholesalers in Canada and the United States who sell to end-users. These wood products are consumed in the home construction, renovation and industrial markets. Our marketing efforts for lumber products are focused on providing our customers with efficient value added supply chain integration, ensuring a high level of customer satisfaction and achieving a balanced and diversified customer base for our products. In 2004, approximately 27% of sales of wood products were made in Canada and 73% were made in the United States.

In addition to producing dimensional lumber and studs, we manufacture lumber that is graded according to recognized standards, such as Premium, Select, J-Grade and Machine Stress Rated lumber. Domtar also has a 50% interest in a facility in Sault Ste. Marie, Ontario that began manufacturing I-joists in 2002. During the first quarter of 2004, we created a 50-50 joint venture with Gogama Forest Products Ltd., to form a fully-integrated sawmill, kiln and planer operation in northern Ontario with an annual capacity of approximately 60 million board feet of lumber. In early 2005, we announced, in conjunction with Tembec Inc., the restructuring of our northeastern Ontario sawmill operations, resulting in the permanent closure of our Chapleau sawmill as of March 6, 2005 and an investment in a new finger-jointed plant with Tembec Inc. to be located on the current site of Tembec s Kirkland Lake sawmill, which is slated for closure. This initiative will allow us to add a third shift at the jointly-owned Elk Lake sawmill in April 2005 to process fiber that will become available after the closure of the Tembec Inc. sawmill at Kirkland Lake.

Fiber Supply

We use hardwood and softwood fiber for the production of paper and softwood for the production of lumber. Our forestry strategy is to optimize wood flows within our fiber supply area and to maximize value and minimize cost while securing an adequate wood supply for our operations. We focus both on the delivery of fresh, high-quality recently harvested wood (which is more resistant to staining and insect attack and has a higher moisture content, making it easier for sawmills to maximize the lumber manufactured from each log) and on the sorting of species (which helps maximize fiber use and ensures better quality downstream products).

We seek to optimize 18 million acres of forestlands for which the Corporation is wholly responsible through efficient management and the application of certified sustainable forest management practices such that a continuous supply of wood is available for future needs. Site preparation, planting and harvesting techniques are continually improved through a variety of methods, including tree improvement and silvicultural research. All our forestlands in Canada have received ISO 14001 certification. Such certification requires introducing rigorous documentation, standardized forest management practices and provisions for continuous improvement. We have also received FSC certification for our forest management practices on lands in central Ontario (in 2001). The FSC is an independent non-profit organization that sets internationally accepted standards for environmental sustainability. As a result of this forest certification, we began the manufacture and sale, during 2003, of paper grades certified by the FSC. Forest products may carry the FSC logo only when a required minimum of fiber content is traceable to an FSC-certified forest of origin and is documented by a full chain-of-custody review. In November 2003, the Corporation undertook to attain FSC certification for all of its 18 million acres of directly licensed and owned forestlands by the end of 2006, subject to the successful completion of two boreal forest pilot projects. As of December 31, 2004, the Ontario boreal forest pilot FSC audit had been completed in addition to two others on Domtar co-managed forests in northern Ontario. Certification is expected in 2005 for these pilot projects. Our 2004 Val-d Or FSC boreal pilot certification has been postponed until discrepancies between FSC standards and Quebec forestry legislation are addressed.

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In Quebec and Ontario, our harvesting rights on public lands provide an annual allowable harvest of approximately 5 million cubic meters of wood. Access to harvesting of fiber on public lands in Quebec and Ontario is subject to review by the respective governmental authorities. Our freehold land of approximately 900,000 acres in Quebec, Ontario and Maine provide an annual allowable harvest of approximately 0.5 million cubic meters of wood.

In Quebec, our annual allowable harvest of approximately 2.5 million cubic meters, derived on a sustained yield basis from public land granted by the Ministry of Natural Resources (Quebec) and from our own freehold lands can supply almost all the logs needed for two-shift operations of our northern Quebec sawmills. The chips produced by these sawmills provide approximately 80% of the fiber requirements of the pulp mill at Lebel-sur-Quévillon. The remaining required fiber is purchased under various contractual arrangements and on the open market.

In Ontario, our annual allowable harvest amounts to approximately 2.5 million cubic meters pursuant to Sustainable Forest Licenses, or SFLs, that have been granted by the Ontario Ministry of Natural Resources. These SFLs are granted either directly to Domtar, to SFL management companies in which Domtar is a shareholder or to SFL holders with whom Domtar has no direct association. We obtain approximately 80% of the wood fiber required for our northern sawmill operations and our Espanola pulp mill either directly or indirectly from these harvesting rights and from our own freehold lands. The remaining required fiber is purchased under various contractual arrangements and on the open market. Most of the by-product volume (sawdust and shaving) is sold to manufacturers of engineered wood and paperboard.

Several years ago, the Ontario government reduced the amount of public land available for forestry activities. In Quebec, an independent commission (the Coulombe Commission) is recommending a 20% reduction in allowable harvesting volumes over the next two to three years. This Commission s report is currently under review by the Quebec government and a decision is expected in 2005. There is no assurance that access to fiber will continue at the same levels achieved in the past. The cost of softwood fiber and the availability of wood chips may be affected.

Our fine paper mills at Windsor and Cornwall, which consume hardwood fiber, are located in areas where the fiber supply is adequate to sustain all current fiber requirements. The Windsor mill consumes hardwood fiber originating from a variety of sources, including purchases on the open market in Canada and the United States, contracts with Quebec wood producers marketing boards and our own private lands. The part of the mill at Cornwall, which consumes hardwood fiber, has been indefinitely closed pending more favorable economic conditions. When operating, it obtains hardwood fiber mainly from supply contracts and open market purchases both in Canada and the United States, with the balance from our private lands, as well as from public lands in southeastern Ontario pursuant to certain volume agreements with the provincial government. In the past year, fiber has been more expensive for our Windsor and Cornwall mills.

The fiber used by our pulp and paper mills in the United States is primarily hardwood, which is readily available in the market from multiple third-party sources, and secondarily softwood, which is also readily available. The Ashdown, Wisconsin and Woodland mills are sourced by a combination of long-term supply contracts, wood lot management arrangements, advance stumpage purchases, and spot market purchases. Our Ashdown mill was previously supplied with fiber under a procurement contract, which expired in late 2004. In the past year, fiber has been more expensive in the Wisconsin and northern United States. Likewise, there have been temporary fiber availability problems due to weather conditions in the south that has impacted the Ashdown mill.

Packaging Norampac

Our packaging business comprises our 50% ownership interest in Norampac, a joint venture between Domtar Inc. and Cascades Inc. We do not manage the day-to-day operations of Norampac. The Board of Directors of Norampac is composed of four representatives each from Domtar Inc. and Cascades Inc. The Chairman of the Board is proposed by Domtar Inc. and appointed by the Board, while the President and Chief Executive Officer is proposed by Cascades Inc. and appointed by the Board. Norampac s debt is non-recourse to Domtar Inc. As required by Canadian Generally Accepted Accounting Principles (GAAP), we account for our 50% interest in

Norampac using the proportionate consolidation method. Our Packaging business represented 12% of consolidated sales in 2004 compared to 12% of consolidated sales in 2003.

Norampac operates eight containerboard mills, five of which are located in Ontario and Quebec, one in British Columbia, one in New York State and one in northern France. The combined annual capacity of Norampac s containerboard mills is approximately 1.6 million tons. These mills use a mix of recycled and virgin fiber to produce both standard and high performance grades of linerboard and corrugated medium, as well as gypsum board in a wide range of basis weights. Through its corrugated packaging plant operations, Norampac converts approximately 65% of its North American containerboard production, directly or indirectly, into corrugated containers. The remaining containerboard production is sold to other converters in North America, Europe and other export markets.

Norampac s network of 26 corrugated packaging plants, strategically located across Canada and the United States, produces a broad range of products for sale to both regional and national customers in a variety of industries, including the food, beverage and consumer products industries. These plants produce a wide range of products, from corrugated boxes and containers for shipping and packaging, to specialty products such as intricate die-cut irregular size boxes, moisture resistant wax-coated and wax impregnated boxes, corrugated pallets, protective packaging products and litho-laminated point-of-purchase products. Norampac also provides customers with services such as graphic design and computer-aided sample making. Norampac s containerboard mills supply essentially all of the containerboard requirements of the converting plants directly or indirectly.

In 2004, approximately 64% of Norampac s sales were made to customers in Canada, 27% to customers in the United States and 9% to customers elsewhere.

During 2004, Norampac acquired two corrugated products plants in Thomson, Connecticut and Lancaster, New York. Norampac also announced the closure, slated for the first quarter of 2005, of its Concord, Ontario corrugated product plant aimed at improving efficiency and profitability.

During 2003, Norampac acquired a corrugated products plant located in Schenectady, New York and transferred its operating assets of the Dallas-Forth Worth, Texas plant as part of the purchase price. Norampac also sold its Monterey, Mexico corrugated product plant to the plant s management team.

Competition

Markets for our products are highly competitive, with a number of major companies competing in each market. We compete with both Canadian and U.S. producers in all of our product lines and with global producers in certain of our product lines, some of which may have greater financial resources and lower production costs than Domtar. In addition, we may compete with product substitutes. Refer to the Risk Factors section for a more detailed discussion on the foregoing.

While the principal basis for competition is selling price, competition can be based upon quality and customer service, including, in some cases, providing technical advice to customers. Other factors, such as foreign exchange rates, cost of fiber, as well as the ongoing softwood lumber dispute between the U.S. and Canada, can also have an impact on our competitive position.

Employee Relations

As at December 31, 2004, we had approximately 6,600 employees in Canada of which approximately 4,600 are unionized, and approximately 4,000 employees in the United States of which approximately 2,700 are unionized, for a total of 10,600 employees, excluding Norampac.

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Number of employees per segment as at December 31, 2004

Papers	7,600
Paper Merchants	950
Wood	1,750
Corporate	300
Total number of employees	10,600

As at December 31, 2004, Norampac had approximately 4,100 employees in Canada of which approximately 50% are unionized, approximately 800 employees in the United States of which approximately 45% are unionized and approximately 200 unionized employees in France, for a total of 5,100 employees.

Our business strategies include supporting the personal growth and participation of employees. We encourage employees to be involved in workshops aimed at producing better performance, greater operating efficiencies or safer operating procedures.

We continue to be committed to ensuring that safe operating practices are established, implemented and maintained throughout our organization. All of our operations have active health and safety programs in place. In 2004, a Health and Safety Due Diligence program was implemented throughout the Corporation.

Papers

The bulk of the collective agreements covering the Papers segment in Canada were last renewed in 1999 for four to six year terms. In November 2003, employees at our Vancouver paper mill went on strike after rejecting our offer for the renewal of their collective agreement. In January 2004, the strike was resolved and a new five-year labor agreement was signed with the Communications, Energy and Paperworkers Union of Canada. Negotiations are ongoing for the renewal of certain collective agreements that expired between April and September 2004 for our Cornwall, Ottawa-Hull, Espanola and Lebel-sur-Quévillon mills. The collective agreement at the Windsor mill will expire in April 2005.

Collective agreements in the United States covering employees at the Ashdown and Woodland mills were renewed for six-year terms at the end of 2001. In the third quarter of 2003, new six-year collective agreements were signed with PACE (Paper, Allied-industry, Chemical and Energy workers) union members at our Port Huron mill. All our collective agreements at the Wisconsin mills were negotiated and renewed for six-year terms in 2003 and 2004.

Paper Merchants

Within the Paper Merchants segment, in Canada, two collective agreements covering about 50 employees in Montreal and Quebec were renewed in 2003 for a four-year term. In the United States, the Pennsauken Ris Paper location renewed its collective agreements in 2003 for three and four year terms for the warehouse employees and the drivers. The collective agreements covering two of our Ris Paper locations will expire in 2006. Negotiations are ongoing for the renewal of certain collective agreements covering employees in one location in the United States and in four locations in Canada.

Wood

Within the Wood segment, collective agreements were concluded with unions in 2000, 2001 and 2002 at the majority of sawmill locations for terms of seven to ten years. During 2003, unionized employees at the Grand-Remous sawmill ratified a new collective agreement for a six-year term and unionized forest employees in Espanola ratified a new four-year agreement. Several collective agreements will expire in 2005 and four collective agreements ending in 2009 will be reopened related to specific issues only.

A significant labor dispute experienced within the past five years was an eight-month strike at the Nairn Center sawmill ending in 2001.

Packaging

Norampac s management renegotiated collective agreements at its Burnaby containerboard mill and at its Etobicoke, Moncton, Richmond and Vaudreuil corrugated container plants in 2004. The Burnaby mill was on strike from April to December 2004.

Norampac s management is currently undertaking negotiations for the renewal of its Red Rock and Trenton linerboard mills collective agreements.

Environmental Matters

Environmental expenditures for effluent treatment, air emission, landfill operation and closure, asbestos containment and removal, bark pile management, silvicultural activities and site remediation (together referred to as environmental matters) are expensed or capitalized depending upon their future economic benefit. In the normal course of business, we incur certain operating costs for environmental matters that are expensed as incurred. Expenditures for property, plant and equipment that prevent future environmental contamination are capitalized and amortized on a straight-line basis over ten to 40 years. Provisions for environmental matters are not discounted and are recorded when remediation efforts are likely and can be reasonably determined.

While we believe that we have determined the costs for environmental matters likely to be incurred, based on known information, our ongoing efforts to identify potential environmental concerns that may be associated with our former and present operations may lead to future environmental investigations. These efforts may result in the determination of additional environmental costs and liabilities, which cannot be reasonably estimated at this time.

As at December 31, 2004, we had a provision of $57 million for environmental matters and other asset retirement obligations, of which $31 million was relating to our Papers segment, $1 million relating to our Wood segment, $2 million relating to our Packaging segment and $23 million was taken at the Corporate level. Additional costs, not known or identifiable, could be incurred for remediation efforts. Based on policies and procedures in place to monitor environmental exposure, we believe that such additional remediation costs would not have a material adverse effect on our financial position, earnings or cash flows.

In addition, the pulp and paper industry in the United States is subject to Cluster Rules and Boiler M.A.C.T. (Maximum Achievable Control Technology) Rules that further regulate effluent and air emissions. We comply with all present regulations and we anticipate spending approximately $52 million over the next three years to meet such requirements.

As at December 31, 2004, anticipated payments in each of the next five years are as follows:

(In millions of Canadian dollars)	**2005**	**2006**	**2007**	**2008**	**2009**	**Thereafter**	**Total**
Environmental matters	21	7	2	2	2	23	57
Cluster Rules obligation	14	8					22
Boiler M.A.C.T. Rules obligation		18	12				30

	35	33	14	2	2	23	109

In 2004, our operating expenses for environmental matters totaled $69 million. We capitalized an additional $22 million for environmental projects mainly related to the improvement of air emissions, effluent treatment as well as remedial actions taken to address environmental compliance of which $17 million related to our Papers segment and $5 million related to our Packaging segment. In 2005, we expect to capitalize approximately

$27 million for environmental projects, including Cluster Rules and Boiler M.A.C.T. Rules obligations, of which $24 million relates to our Papers segment, $1 million relates to our Wood segment and $2 million relates to our Packaging segment. We are not able to estimate the total amount of capital expenditures (other than Cluster Rules and Boiler M.A.C.T. Rules obligations) that may be required beyond 2005 for environmental compliance. However, we do not expect any additional required expenditure to have a material adverse effect on our financial position, earnings or cash flows.

Social and Environmental Policies

The Corporation has several social and environmental related policies including, among others, Human Rights, Forest, Environment, and Health and Safety policies. These form an integral part of our Code of Ethics which may be found on our website at **www.domtar.com**.

Risk Factors

Product Prices and Industry Conditions

Our financial performance is sensitive to the selling prices of our products that are impacted by supply and demand.

The markets for most paper, pulp, lumber and packaging products are cyclical and are influenced by a variety of factors beyond our control. These factors include periods of excess product supply due to industry capacity additions, periods of decreased demand due to weak general economic activity in North America or international markets, inventory de-stocking by customers, and fluctuations in currency exchange rates. Demand for lumber also depends on the level of housing starts, commercial building activity and the availability and cost of mortgage financing.

In addition, we may compete with product substitutes, which can impact demand for our products. Our paper products compete with electronic transmission and document storage alternatives, as well as grades of paper we do not produce. As the use of these alternatives grows, demand for our paper products may decline or shift to other paper grades. Moreover, demand for some of our wood products may decline if customers purchase steel alternatives. Demand for some of our corrugated container products may decline if customers purchase plastic alternatives. Any substantial shift in demand from our products to competing technologies or materials could have a material adverse effect on our business, financial results and financial condition.

During periods of low prices, we have experienced in the past, and could experience in the future, reduced revenues and margins, resulting in substantial declines in profitability and sometimes, net losses.

Foreign Exchange

The revenues for most of our products are affected by fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar. As a result, any decrease in the value of the U.S. dollar relative to the Canadian dollar reduces our profitability. Our U.S. dollar sales, net of U.S. dollar purchases for our operating activities, represent approximately US$1 billion annually (excluding Norampac). In addition, our sales in Canada are impacted by the exchange rate fluctuations, as the prices for many of our products are generally driven by U.S. prices of similar products. Our exposure to the U.S. dollar is reduced by interest on our U.S. dollar denominated debt (approximately $0.1 billion annually, excluding Norampac). Exchange rate fluctuations are beyond our control and the U.S. dollar may continue to depreciate against the Canadian dollar in the future, which would result in lower revenues and margins.

Operational Risks

The activities conducted by our businesses are subject to a number of operational risks including competition, performance of key suppliers and distributors, renewal of collective agreements, regulatory risks, successful integration of new acquisitions, retention of key personnel and reliability of information systems. In addition, operating costs for our businesses can be affected by changes in energy prices, fiber prices, other raw material prices and freight costs as a result of changing economic or political conditions or due to particular supply and demand considerations.

Fiber supply

We use hardwood and softwood fiber for the production of paper and softwood for the production of lumber. Our forestry strategy is to optimize wood flows within our fiber supply area and to maximize value and minimize cost while securing an adequate wood supply for our operations. Our hardwood and softwood fiber resources are obtained from harvesting rights on public lands, purchases from third parties and from our owned land.

Several years ago, the Ontario government reduced the amount of public land available for forestry activities. In Quebec, an independent commission (the Coulombe Commission) is recommending a 20% reduction in allowable harvesting volumes over the next two to three years. This Commission s report is currently under review by the Quebec government and a decision is expected in 2005.

There is no assurance that access to fiber will continue at the same levels achieved in the past. The cost of hardwood and softwood fiber and the availability of wood chips may be affected.

Environment

We are subject to U.S. and Canadian environmental laws and regulations for effluent and air emissions, harvesting, silvicultural activities, waste management and groundwater quality, among others. These laws and regulations require us to obtain and comply with the authorization requirements of the appropriate governmental authorities, who exercise considerable discretion for permit issuances and their timing. Changes in environmental laws and regulations and/or their application may require us to make significant expenditures that could negatively impact our financial results and financial condition.

Failure to comply with applicable environmental laws, regulations and permit requirements may result in fines, penalties or enforcement actions by the regulators, including regulatory or judicial orders enjoining or curtailing operations or requiring corrective measures, installation of environmental control equipment or remedial actions, any of which could entail significant expenditures and negatively impact our financial results and financial condition.

We continue to take remedial action under our Care and Control program at a number of former operating sites, especially in the wood preserving sector, due to possible soil, sediment or groundwater contamination. The investigation and remediation process is lengthy and subject to the uncertainties of changes in legal requirements, technological developments and the allocation of liability among potentially responsible parties.

In addition, the pulp and paper industry in the United States is subject to Cluster Rules and Boiler M.A.C.T. Rules that further regulate effluent and air emissions. We comply with all present regulations.

Lumber Export Duties

The United States Department of Commerce announced that it had imposed cash deposit requirements on the Canadian softwood lumber industry with a final aggregate countervailing and antidumping rate of 27.22%, that is, 18.79% for countervailing and 8.43% for antidumping. Since May 22, 2002, based upon a final decision of the United States International Trade Commission, we have made the required cash deposits on our exports of softwood lumber to the United States. The Canadian government has challenged both the countervailing and antidumping rates with the World Trade Organization and the North American Free Trade Agreement. As of January 1, 2005, cash deposits for countervailing and antidumping duties are being made and expensed by Domtar at a new rate of 20.95%, that is, 17.17% for countervailing and 3.78% for antidumping.

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We are currently experiencing, and may continue to experience, reduced revenues and margins in our Wood business as a result of countervailing and antidumping duty applications or any new arrangements between the United States and Canada.

Legal Proceedings

In the normal course of our operations, we become 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 as at March 24, 2005 cannot be predicted with certainty, it is our belief that their resolution will not have a material adverse effect on our financial position, earnings or cash flows.

In April 2003, the Canadian Competition Bureau (the Bureau) began an investigation of Canada s major distributors of carbonless paper and other fine paper products, including our Paper Merchants in Canada. In March 2004, the Bureau expanded its investigation to include dealings between the Corporation and Xerox Canada Limited. Although the investigation is continuing, we are not able to predict the outcome of this investigation or the impact, if any, it may have on us.

DIVIDENDS

During each of the years indicated, the Corporation declared the following dividends:

	2004	2003	2002
Aggregate dividends (in millions of Canadian dollars)			
Series A Preferred Shares	0.1	0.2	0.2
Series B Preferred Shares	1.1	1.4	1.3
Common Shares	55.1	49.1	31.8
Dividends per share (in Canadian dollars per share)			
Series A Preferred Shares	2.25	2.25	2.25
Series B Preferred Shares	0.73	0.86	0.75
Common Shares	0.24	0.22	0.14

Regular quarterly dividends on the outstanding Series A and Series B Preferred Shares were paid throughout the three-year period ended December 31, 2004. Cash dividends on common shares have been paid since January 1996. The Corporation s current dividend policy is to pay out a dividend of $0.06 per share quarterly ($0.24 per share annually). Prior to April 2003, the Corporation s dividend policy was to pay out a dividend of $0.035 per share quarterly ($0.14 per share annually).

Agreements related to the Corporation s 10.85% Debentures due 2017 and 10% Debentures due 2011 contain covenants restricting the payment of dividends on its shares (other than stock dividends) and the purchase, redemption, reduction or other payment with respect to shares of its capital stock, none of which restrict the payment of dividends on or the satisfaction of mandatory retirement provisions with respect to the Series A Preferred Shares and the Series B Preferred Shares. No dividends may at any time be paid or declared and set apart for payment on the Common Shares unless all accumulated dividends, where applicable, on the Series A Preferred Shares and the

Series B Preferred Shares have been paid or declared and set apart, including the current quarterly installment of dividends.

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DESCRIPTION OF CAPITAL STRUCTURE

General Description of Capital Structure

Our authorized share capital consists of an unlimited number of common shares, Series A preferred shares and Series B preferred shares.

Common shares

The Corporation is authorized to issue an unlimited number of common shares. Holders of our common shares are entitled to one vote per share at any meeting of our shareholders. Holders of our common shares are, subject to the rights of the holders of our preferred shares, entitled to receive any dividend declared by our Board of Directors. There were 230,408,313 common shares issued and outstanding as at February 28, 2005.

As at February 28, 2005, there were 5,215,929 common share purchase options issued and outstanding under the Executive stock option and Share purchase plan.

Preferred shares

The authorized preferred shares consist of preferred shares issuable in an unlimited number of series, ranking equal with respect to the payment of dividends and the distribution of assets, but prior to the Common Shares.

The Series A preferred shares are non-voting and redeemable at the Corporation s option at $25.00 per share. These shares carry a cumulative cash dividend per share of $2.25 per annum. There were 69,576 Series A preferred shares issued and outstanding as at February 28, 2005.

The Series B preferred shares are non-voting and redeemable at the Corporation s option at $25.00 per share. These shares carry a cumulative cash dividend equivalent to 72% of the bank prime rate. There were 1,470,000 Series B preferred shares issued and outstanding as at February 28, 2005.

The Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, 1% of the number of Series A and Series B Preferred shares that were outstanding on April 2, 1992 at prices not exceeding $25.00 per share.

Ratings

Rating Agency	Security	Rating
Dominion Bond Rating Service	Unsecured Notes and Debentures Preferred Shares	BBB (low) Pfd-4 (high)
Moody s	Unsecured Notes and Debentures	Baa3
Standard & Poor s	Unsecured Notes and Debentures	BBB-

The above ratings represent a risk assessment of our public unsecured debt securities. The rating by Dominion Bond Rating Service is the fourth most favorable rating in terms of quality within ten rating gradations with the low indicating a ranking in the lower end of this rating category. The rating by Moody s is the fourth

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most favorable rating in terms of quality within nine rating gradations with the numerical modifier 3 indicating a ranking in the lower end of this rating category. The rating by Standard & Poor s is the fourth most favorable rating in terms of quality within ten rating gradations with the minus indicating a ranking in the lower end of this rating category. Both Moody s and Standard & Poor s have a negative outlook with respect to our credit ratings.

A reduction in our credit ratings could impact our access to and cost of capital and financial flexibility in the future. The above ratings are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the above rating agencies.

MARKET FOR SECURITIES

Trading Price and Volume

The Corporation s Common Shares, Series A Preferred Shares and Series B Preferred Shares are listed on the Toronto Stock Exchange (TSX). The Corporation s Common Shares are also listed on the New York Stock Exchange.

TSX

	Common shares			Series A preferred shares			Series B preferred shares		
	Price per share		Volume	Price per share		Volume	Price per share		Volume
	High	Low		High	Low		High	Low	
Jan-04	16.84	15.04	18,999,453	30.00	28.10	3,010	24.30	24.15	9,700
Feb-04	15.99	14.77	17,127,231	34.00	30.00	3,460	25.00	24.10	188,432
Mar-04	16.07	14.45	24,094,334	34.00	30.00	2,216	24.75	24.40	98,350
Apr-04	17.35	15.55	20,724,982	30.30	30.00	900	24.75	24.35	302,400
May-04	17.30	15.11	15,607,823	31.90	31.90	400	24.95	24.40	18,200
Jun-04	17.95	16.80	17,736,386	32.50	30.50	993	24.95	24.50	9,950
Jul-04	17.50	16.70	10,625,660	33.00	30.00	1,020	25.00	24.51	6,200
Aug-04	17.25	15.45	10,570,441	34.00	32.50	1,400	25.25	24.50	34,300
Sep-04	16.32	15.02	13,872,502	33.50	30.50	850	24.99	24.50	16,350
Oct-04	16.02	14.26	16,304,333	32.50	30.50	550	25.00	24.70	3,900
Nov-04	15.25	13.65	19,188,150	34.00	30.50	2,500	25.00	24.60	37,450
Dec-04	15.09	14.05	11,057,764	31.50	31.25	956	24.90	24.65	15,100

ESCROWED SECURITIES

To our knowledge, the following summarizes the securities of the Corporation held in escrow as at February 28, 2005:

Escrowed Securities

Designation of Class	Number of Securities held in Escrow	% of Class
Common shares[1]	1,190,184	0.005%

[1] Pursuant to our Executive Stock Option and Share Purchase Plan, common shares are held in escrow with the escrow agent (Computershare), for a maximum of ten years, as guarantee until the repayment of loans granted to the participants upon the exercise of rights, or before if the employee leaves Domtar.

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DIRECTORS AND OFFICERS

Directors

Pursuant to the amendment to the Articles of the Corporation, approved by the shareholders at the annual meeting held on April 29, 2004, the Board of Directors of the Corporation appointed two more directors, Messrs. Jack C. Bingleman and Raymond Chrétien, thus bringing to eleven the total number of directors. The term of each director runs from the time of his election to the next succeeding annual meeting of shareholders.

As at March 24, 2005, the names, municipalities of residence, positions with the Corporation and principal occupations of the directors of the Corporation and the period during which each director has served as such are as follows:

Name	Principal Occupation	Served as Director of the Corporation since
Jack C. Bingleman Vero Beach, Florida, USA	President, Indian River Asset Management Inc.	2005
Raymond Chrétien Montreal, Quebec, Canada	Strategic Advisor, Fasken Martineau DuMoulin LLP	2004
Paul-Henri Couture Laval, Quebec, Canada	Vice-President, Capital d Amérique CDPQ Inc., a wholly-owned subsidiary of Caisse de dépôt et placement du Québec	1994
Louis P. Gignac Longueuil, Quebec, Canada	President and Chief Executive Officer, Cambior Inc.	1995
Claude R. Lamoureux Toronto, Ontario, Canada	President and Chief Executive Officer, Ontario Teachers Pension Plan	1992
Jacques Laurent Montreal, Quebec, Canada	Partner, Borden Ladner Gervais LLP	1996
Brian M. Levitt Montreal, Quebec, Canada	Chair of the Board of Directors of the Corporation; Co-Chair and Partner, Osler, Hoskin & Harcourt LLP	1997
Gilles Ouimet Montreal, Quebec, Canada	Corporate Director	2004
		1997

Louise Roy Montreal, Quebec, Canada	Associate Fellow; Chair, Leadership for Tomorrow Forum - CIRANO	
Raymond Royer Montreal, Quebec, Canada	President and Chief Executive Officer of the Corporation	1996
Edward J. Waters Greenwich, Connecticut, USA	Chair, President and Chief Executive Officer, Cape & Islands Investment Company Ltd.	1982

The above-mentioned directors have held their principal occupation or held executive positions with the same firm or affiliated firms for the past five years, except as follows: Mr. Jack C. Bingleman was, prior to 2001, President and Director of Staples International Inc. (Europe); Mr. Raymond Chrétien was, prior to 2004, Ambassador of Canada to France from 2000 to 2003; Mr. Jacques Laurent was, prior to November 2003, Chair of the Board of Hydro-Québec and prior to November 2001, senior partner at Gowling Lafleur Henderson; Mr. Gilles Ouimet was, prior to May 2004, Chair of the Board of Directors of Pratt & Whitney Canada, and prior to May 2002, President and CEO of the same company; Ms. Louise Roy was, prior to December 2002, Vice-President Marketing and Commercial Services and Representative in Canada of the International Air Transport Association (IATA).

The table below indicates the committees of the Board of Directors, with their respective membership as at March 24, 2005:

AUDIT COMMITTEE	**Louis P. Gignac Chair** Claude R. Lamoureux Jacques Laurent Gilles Ouimet
HUMAN RESOURCES COMMITTEE	**Brian M. Levitt Chair** Paul-Henri Couture Louise Roy
NOMINATING AND CORPORATE GOVERNANCE COMMITTEE	**Claude R. Lamoureux Chair** Jacques Laurent Edward J. Waters
ENVIRONMENT AND HEALTH AND SAFETY COMMITTEE	**Jacques Laurent Chair** Gilles Ouimet Louise Roy Raymond Royer
PENSION COMMITTEE	**Claude R. Lamoureux Chair** Brian M. Levitt Raymond Royer Edward J. Waters

Officers

The following table sets forth information concerning the non-director executive officers of the Corporation who, together with the President and Chief Executive Officer, Mr. Raymond Royer, form the Management Committee as at March 24, 2005:

Name	Principal Occupation
Steven A. Barker, South Lebanon, OH, USA	Senior Vice President, Pulp and Paper Sales and Marketing
Robert J. Belanger, St. Clair, MI, USA	Senior Vice President, Specialty Papers
Claude Belley, Boucherville, Quebec, Canada	Senior Vice President, Human Resources

Roger H. Brear, Bradenton, Florida, USA	Senior Vice President, Paper Manufacturing

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Name	Principal Occupation
Daniel Buron, St-Lambert, Quebec, Canada	Senior Vice President and Chief Financial Officer
Richard Garneau, Beaconsfield, Quebec, Canada	Senior Vice President, Forest Products
James F. Lenhoff, Ludlow, KY, USA	Senior Vice President, Paper Merchants
Hubert Pelletier, Boucherville, Quebec, Canada	Senior Vice President, Paper Supply Chain
Gilles Pharand, Laval, Quebec, Canada	Senior Vice President, Corporate Affairs and General Counsel
Pierre Trudel, Lennoxville, Quebec, Canada	Senior Vice President, Pulp and Paper Technology

The above-mentioned officers have held their principal occupations or held executive positions with the same firm or affiliated firms for the past five years, except as follows: Mr. Barker was, prior to January 2004, President of Ris Paper, a subsidiary of the Corporation acquired in July 2000; Mr. Belanger was, from June 2000 to July 2004, General Manager of our Port Huron Mill and, from July to December 2004, Vice-President, Technology; Mr. Belley, over the 22 years he has been with the Corporation, has held various senior operating positions and was, prior to August 2001, Vice-President of our Cornwall mill; Mr. Brear was, prior to August 2001, Senior Vice-President, Manufacturing, Paper with Georgia-Pacific Corporation; Mr. Buron was, prior to May 2004, Vice-President, Finance, Pulp & Paper Sales Division and, prior to September 2002, he was Vice-President and Controller; Mr. Garneau was, prior to October 2002, Vice-President and Chief Financial Officer of Norampac Inc.; Mr. Lenhoff was, prior to December 2004, Vice-President General Manager, Cincinnati Branch, of Domtar Distribution Group and, prior to March 2004, Vice-President Sales and Marketing of Ris Paper where he also held other senior management positions; Mr. Pelletier was, prior to December 2004, Vice-President, Premium Paper Manufacturing, prior to August 2004, Vice-President, Procurement and Transportation and, prior to August 2001, Vice-President, Shared Services; and Mr. Trudel, over the 37 years he has been with the Corporation, has held various senior operating positions and was more recently, prior to December 2004, Vice-President, Printing and Imaging Paper Manufacturing.

As at February 28, 2005 the directors and officers of the Corporation, as a group, beneficially owned, directly or indirectly, or exercised control or direction over 710,505 Common Shares representing approximately 0.3% of the outstanding Common Shares of the Corporation.

TRANSFER AGENT AND REGISTRARS

For Common Shares and Series A and B Preferred Shares and Debentures:

Computershare Trust Company of Canada
Shareholder Services
1500 University Street
Suite 700
Montreal, Qc, Canada H3A 3S8
Tel.: 1-866-245-4053
Also in Halifax, NS; Toronto, ON; Calgary, AB and Vancouver, BC

For Common Shares only:

The Bank of New York
101 Barclay Street, 8 West
New York, NY 10286
U.S.A.
Tel: 212-815-2923

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ADDITIONAL INFORMATION

Additional information, including directors and officers remuneration and indebtedness, principal holders of the Corporation s securities, options to purchase securities and interests of insiders in material transactions, where applicable, is contained in Domtar s proxy circular for its most recent annual meeting of shareholders that involved the election of directors.

Additional financial information is available in Domtar s audited consolidated financial statements and Management s Discussion & Analysis for the financial year ended December 31, 2004.

Copies of these documents may be obtained upon request from the Corporate Secretary of the Corporation, Domtar Inc., 395 de Maisonneuve Boulevard West, Montréal, Québec H3A 1L6 or on Domtar s Internet site: http://www.domtar.com or at http://www.sedar.com.

In addition, when the Corporation s securities are in the course of a distribution pursuant to a short-form prospectus or when a preliminary short-form prospectus has been filed, the following documents may be obtained free of charge from the Corporate Secretary of the Corporation:

i) one copy of the Annual Information Form, together with one copy of any documents or portion thereof incorporated therein by reference;

ii) one copy of Domtar s comparative financial statements for its most recently completed financial year together with the report of the auditors thereon and one copy of any interim financial statements of Domtar subsequent to the financial statements for its most recently completed financial year;

iii) one copy of Domtar s management proxy circular for its most recent annual meeting of shareholders which involved the election of directors; and

iv) one copy of any other documents that are incorporated by reference in the preliminary short form prospectus or the short form prospectus.

At any other time, one copy of the documents referred to in subparagraphs i, ii and iii above will be provided free of charge upon request to the Corporate Secretary.

AUDIT COMMITTEE INFORMATION

Pursuant to Multilateral Instrument 52-110, and Form 52-110F1, the following disclosure is made:

a) Audit Committee Charter
The Audit Committee Charter may be found in Schedule A of this document.

b) Composition of the Audit Committee

	Independent	Financially Literate
Louis P. Gignac, Chair	Yes	Yes

Claude R. Lamoureux	Yes	Yes
Jacques Laurent	Yes	Yes
Gilles Ouimet	Yes	Yes

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c) Relevant Education and Experience

Louis P. Gignac, Chair	Obtained a degree in engineering from Laval University, a Master of Science (minor in Business) of the University of Minnesota, as well as a Doctorate in Mining Engineering from the University of Missouri-Rolla. As President and CEO of Cambior Inc. since 1986, Mr. Gignac supervises directly and indirectly 50 finance employees in the financial group. He has been a member of the Corporation s Audit Committee, and Chair, since 2002.
Claude R. Lamoureux	President and CEO of the Ontario Teachers Pension Plan since 1990. Previously, he was a financial executive for over 25 years with Metropolitan Life, as well as President and CEO. Mr. Lamoureux is also an actuary, and throughout his extensive career was involved in investment activities overseeing the work of numerous finance and accounting professionals and executives, both in Canada and the U.S. He has been a member of the Corporation s Audit Committee since 2000. He is a member of the Consultative Advisory Group of the International Auditing and Assurance Standards Board.
Jacques Laurent	Studied accounting at the Graduate School of Business of Columbia University, and has been a member of audit committees of public corporations for the last 20 years. As Chairman of the Board of Hydro-Québec, he had the internal auditor report directly to him. As a business lawyer, he was involved in numerous transactions including financial aspects and internal controls and procedures. He has been a member of the Corporation s Audit Committee since 2000.
Gilles Ouimet	A graduate in Engineering Physics of the Royal Military College, Mr. Ouimet also obtained an MBA with specialization in finance and is also a fellow certified management accountant (FCMA). During his career that spans over 30 years, he occupied various senior finance and accounting positions such as CFO and Controller. As President and CEO of Pratt & Whitney Canada, he had the CFO reporting directly to him. He has been a member of the Corporation s Audit Committee since April 29, 2004.

d) Pre-Approval Policy and Procedures

The Audit Committee has adopted since 2003 the Audit and Non-Audit Services Pre-Approval Policy, whereby the Audit Committee must approve audit and non-audit services provided by the Corporation s external auditor, in order to ensure that such services do not impair the external auditor independence.

The Policy may be found on our website at: www.domtar.com

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e) External Auditor Service Fees:

	Years ended December 31,	
(in thousands of Canadian dollars)	**2004**	**2003**
Audit Fees	1,178	1,368
Audit Related Fees	341	422
Tax Fees	32	62
All Other Fees	55	12
Total	1,606	1,864

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UNDERTAKING

The Registrant agrees to make available, in person or by telephone, representatives to respond to inquiries made by the Commission staff, and to furnish promptly, when requested to do so by the Commission staff, information relating to: (i) the securities in relation to which the obligation to file an annual report on Form 40-F arises; or (ii) transactions in said securities.

SIGNATURES

Pursuant to the requirements of the Exchange Act, the Registrant certifies that it meets all of the requirements for filing on Form 40-F and has duly caused this annual report to be signed on its behalf by the undersigned, thereto duly authorized.

Registrant:	Domtar Inc.
By:	/s / Razvan L. Theodoru
	Razvan L. Theodoru Corporate Secretary
Date:	March 24, 2005