

Domtar CORP  
Form 10-Q  
May 08, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from            to

COMMISSION FILE NUMBER 001-33164

**DOMTAR CORPORATION**

(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State of Incorporation)

**20-5901152**  
(I.R.S. Employer Identification No.)

**234 Kingsley Park Drive, Fort Mill, SC 29715**

(Address of principal executive offices) (zip code)

**(803) 802-7500**

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject

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to such filing requirements for the past 90 days. YES  NO

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(do not check if a smaller reporting company)

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

At April 30, 2015, 63,700,903 shares of the issuer's voting common stock were outstanding.

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**DOMTAR CORPORATION**

**FORM 10-Q**

**For the Quarterly Period Ended March 31, 2015**

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**Table of Contents****PART I: FINANCIAL INFORMATION****ITEM 1: FINANCIAL STATEMENTS (UNAUDITED)****DOMTAR CORPORATION****CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE (LOSS) INCOME**

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

|   | For the three months ended |                   |
|---|----------------------------|-------------------|
|   | March 31,<br>2015          | March 31,<br>2014 |
|   | (Unaudited)                |                   |
|   | \$                         | \$                |
| <b>Sales</b>  | <b>1,348</b>               | 1,394             |
| <b>Operating expenses</b>   |                            |                   |
| Cost of sales, excluding depreciation and amortization  | 1,062                      | 1,103             |
| Depreciation and amortization   | 90                         | 99                |
| Selling, general and administrative   | 100                        | 114               |
| Impairment and write-down of property, plant and equipment (NOTE 12)  | 19                         |                   |
| Closure and restructuring costs (NOTE 12)   | 1                          | 1                 |
| Other operating loss (income), net (NOTE 7)   | 5                          | (2)               |
|   | <b>1,277</b>               | 1,315             |
| <b>Operating income</b>   | <b>71</b>                  | 79                |
| Interest expense, net   | 26                         | 25                |
| <b>Earnings before income taxes</b>   | <b>45</b>                  | 54                |
| Income tax expense  | 9                          | 15                |
| <b>Net earnings</b>   | <b>36</b>                  | 39                |
| <b>Per common share (in dollars) (NOTE 5)</b>   |                            |                   |
| Net earnings  |                            |                   |
| Basic   | 0.56                       | 0.60              |
| Diluted   | 0.56                       | 0.60              |
| Weighted average number of common and exchangeable shares outstanding (millions)  |                            |                   |
| Basic   | 63.8                       | 64.9              |
| Diluted   | 63.9                       | 65.0              |
| Cash dividends per common share   | 0.375                      | 0.275             |
| <b>Net earnings</b>   | <b>36</b>                  | 39                |
| <b>Other comprehensive (loss) income (NOTE 13):</b>   |                            |                   |
| Net derivative losses on cash flow hedges:  |                            |                   |
| Net losses arising during the period, net of tax of \$(13) and \$(3), respectively  | (18)                       | (3)               |
| Less: Reclassification adjustment for losses included in net earnings, net of tax of \$(4) and \$(2), respectively                                    | 5                          | 2                 |
| Foreign currency translation adjustments  | (167)                      | (36)              |
| Change in unrecognized gains and prior service cost related to pension and post-retirement benefit plans, net of tax of \$(1) and \$(1), respectively | 2                          | 2                 |
| <b>Other comprehensive loss</b>   | <b>(178)</b>               | (35)              |

|                                    |              |          |
|------------------------------------|--------------|----------|
| <b>Comprehensive (loss) income</b> | <b>(142)</b> | <b>4</b> |
|------------------------------------|--------------|----------|

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

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

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

|  | March 31,<br>2015 | At<br>December 31,<br>2014<br>(Unaudited) |
|--|-------------------|---|
|  | \$                | \$  |
| <b>Assets</b>  |                   |   |
| <b>Current assets</b>  |                   |   |
| Cash and cash equivalents  | 183               | 174                                       |
| Receivables, less allowances of \$10 and \$6                                 | 660               | 628                                       |
| Inventories (NOTE 9)   | 704               | 714                                       |
| Prepaid expenses   | 28                | 25  |
| Income and other taxes receivable  | 12                | 54  |
| Deferred income taxes  | 78                | 75  |
| <b>Total current assets</b>  | <b>1,665</b>      | <b>1,670</b>                              |
| Property, plant and equipment, at cost                                       | 8,726             | 8,909                                     |
| Accumulated depreciation   | (5,731)           | (5,778)                                   |
| <b>Net property, plant and equipment</b>                                     | <b>2,995</b>      | <b>3,131</b>                              |
| <b>Goodwill (NOTE 10)</b>  | <b>537</b>        | <b>567</b>                                |
| <b>Intangible assets, net of amortization (NOTE 11)</b>                      | <b>612</b>        | <b>661</b>                                |
| <b>Other assets</b>  | <b>151</b>        | <b>156</b>                                |
| <b>Total assets</b>  | <b>5,960</b>      | <b>6,185</b>                              |
| <b>Liabilities and shareholders equity</b>                                   |                   |   |
| <b>Current liabilities</b>   |                   |   |
| Bank indebtedness  | 6                 | 10  |
| Trade and other payables   | 697               | 721                                       |
| Income and other taxes payable   | 39                | 26  |
| Long-term debt due within one year   | 169               | 169                                       |
| <b>Total current liabilities</b>   | <b>911</b>        | <b>926</b>                                |
| <b>Long-term debt</b>  | <b>1,179</b>      | <b>1,181</b>                              |
| <b>Deferred income taxes and other</b>                                       | <b>790</b>        | <b>810</b>                                |
| <b>Other liabilities and deferred credits</b>                                | <b>370</b>        | <b>378</b>                                |
| <b>Commitments and contingencies (NOTE 15)</b>                               |                   |   |
| <b>Shareholders equity</b>   |                   |   |
| Common stock   |                   |   |
| \$0.01 par value; authorized 2,000,000,000 shares; issued: 65,001,104 shares | 1                 | 1   |
| Treasury stock (NOTE 14)   |                   |   |
| \$0.01 par value; 1,300,201 and 991,017 shares                               |                   |   |
| Additional paid-in capital   | 2,000             | 2,012                                     |
| Retained earnings  | 1,155             | 1,145                                     |
| Accumulated other comprehensive loss   | (446)             | (268)                                     |
| <b>Total shareholders equity</b>   | <b>2,710</b>      | <b>2,890</b>                              |

|  |              |              |
|--|--------------|--------------|
| <b>Total liabilities and shareholders equity</b> | <b>5,960</b> | <b>6,185</b> |
|--|--------------|--------------|

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

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

|  | Issued<br>and<br>outstanding<br>common shares<br>(millions of shares) | Common stock<br>at par | Additional paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive loss | Total<br>shareholders'<br>equity |
|--|---|------------------------|-------------------------------|----------------------|--|----------------------------------|
|  |   |                        |                               |                      |  |                                  |
|  |   | \$                     | \$                            | \$                   | \$   | \$                               |
|  |   |                        |                               | (Unaudited)          |  |                                  |
| Balance at December 31, 2014   | 64.0  | 1                      | 2,012                         | 1,145                | (268)                                      | 2,890                            |
| Stock-based compensation, net of tax   |   |                        | 1                             |                      |  | 1                                |
| Net earnings   |   |                        |                               | 36                   |  | 36                               |
| Net derivative losses on cash flow hedges:   |   |                        |                               |                      |  |                                  |
| Net losses arising during the period, net of tax of \$(13)   |   |                        |                               |                      | (18)                                       | (18)                             |
| Less: Reclassification adjustments for losses included in net earnings,<br>net of tax of \$(4)                                   |   |                        |                               |                      | 5  | 5                                |
| Foreign currency translation adjustments   |   |                        |                               |                      | (167)                                      | (167)                            |
| Change in unrecognized gains and prior service cost related to<br>pension and post-retirement benefit plans, net of tax of \$(1) |   |                        |                               |                      | 2  | 2                                |
| Stock repurchase   | (0.3)   |                        | (13)                          |                      |  | (13)                             |
| Cash dividends declared  |   |                        |                               | (26)                 |  | (26)                             |
| <b>Balance at March 31, 2015</b>   | <b>63.7</b>   | <b>1</b>               | <b>2,000</b>                  | <b>1,155</b>         | <b>(446)</b>                               | <b>2,710</b>                     |

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

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**DOMTAR CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(IN MILLIONS OF DOLLARS)**

|   | For the three months ended |                   |
|---|----------------------------|-------------------|
|   | March 31,<br>2015          | March 31,<br>2014 |
|   | (Unaudited)                |                   |
|   | \$                         | \$                |
| <b>Operating activities</b>   |                            |                   |
| Net earnings  | 36                         | 39                |
| Adjustments to reconcile net earnings to cash flows from operating activities   |                            |                   |
| Depreciation and amortization   | 90                         | 99                |
| Deferred income taxes and tax uncertainties   | (15)                       |                   |
| Impairment and write-down of property, plant and equipment  | 19                         |                   |
| Net gain on disposal of property, plant and equipment   | (1)                        |                   |
| Stock-based compensation expense  | 2                          | 1                 |
| Other   | (1)                        | 3                 |
| Changes in assets and liabilities, excluding the effects of acquisition of business                                       |                            |                   |
| Receivables   | (44)                       | 9                 |
| Inventories   | (12)                       | (14)              |
| Prepaid expenses  | 2                          | 3                 |
| Trade and other payables  | (10)                       | (23)              |
| Income and other taxes  | 55                         | 20                |
| Difference between employer pension and other post-retirement contributions and pension and other post-retirement expense | 2                          | (2)               |
| Other assets and other liabilities  | 4                          | 6                 |
| Cash flows provided from operating activities   | 127                        | 141               |
| <b>Investing activities</b>   |                            |                   |
| Additions to property, plant and equipment  | (70)                       | (45)              |
| Proceeds from disposals of property, plant and equipment  | 1                          |                   |
| Acquisition of business, net of cash acquired   |                            | (546)             |
| Cash flows used for investing activities  | (69)                       | (591)             |
| <b>Financing activities</b>   |                            |                   |
| Dividend payments   | (24)                       | (18)              |
| Net change in bank indebtedness   | (4)                        | (8)               |
| Change in revolving bank credit facility  |                            | (80)              |
| Proceeds from receivables securitization facilities   |                            | 90                |
| Payments on receivables securitization facilities   |                            | (58)              |
| Repayment of long-term debt   | (1)                        |                   |
| Stock repurchase  | (13)                       |                   |
| Other   | 1                          | 1                 |
| Cash flows used for financing activities  | (41)                       | (73)              |
| <b>Net increase (decrease) in cash and cash equivalents</b>   | <b>17</b>                  | <b>(523)</b>      |
| Impact of foreign exchange on cash  | (8)                        | (2)               |
| Cash and cash equivalents at beginning of period  | 174                        | 655               |

|   |             |     |
|---|-------------|-----|
| <b>Cash and cash equivalents at end of period</b> | <b>183</b>  | 130 |
| <b>Supplemental cash flow information</b>         |             |     |
| Net cash payments for:                            |             |     |
| Interest  | <b>27</b>   | 22  |
| Income taxes refund, net                          | <b>(23)</b> | (1) |

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

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**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015**

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

**(UNAUDITED)**

**NOTE 1.**

**BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, in the opinion of Management, include all adjustments that are necessary for the fair statement of Domtar Corporation's (the Company) financial position, results of operations, and cash flows for the interim periods presented. Results for the first three months of the year may not necessarily be indicative of full year results. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Domtar Corporation Annual Report on Form 10-K for the fiscal year ended December 31, 2014, as filed with the Securities and Exchange Commission. The December 31, 2014 Consolidated Balance Sheet, presented for comparative purposes in this interim report, was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

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**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2015**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 2.**

**RECENT ACCOUNTING PRONOUNCEMENTS**

**ACCOUNTING CHANGES IMPLEMENTED**

**DISCONTINUED OPERATIONS**

In April 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-08, an update on Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The amendments in this update change the requirements for reporting discontinued operations and require additional disclosures for both disposal transactions that meet the criteria for a discontinued operation and disposals that do not meet these criteria. The objective of this update is to reach a greater convergence between the FASB's and IASB's reporting requirements for discontinued operations.

The Company adopted the new requirement on January 1, 2015 with no impact on the Company's consolidated financial statements, as no triggering event occurred throughout the period.

**FUTURE ACCOUNTING CHANGES**

**CLOUD COMPUTING ARRANGEMENTS**

In April 2015, the FASB issued ASU 2015-05, an update on customer's accounting for fees paid in a cloud computing arrangement. The ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract.

The ASU is effective for interim and annual periods beginning after December 15, 2015. Early adoption is permitted. The Company does not expect these changes to have a material impact on the consolidated financial statements.

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**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2015**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 3.****ACQUISITION OF BUSINESS***Acquisition of Laboratorios Indas*

On January 2, 2014, Domtar Corporation completed the acquisition of 100% of the outstanding shares of Laboratorios Indas, S.A.U. ( Indas ), primarily a branded incontinence products manufacturer and marketer in Spain. Indas has approximately 570 employees and operates two manufacturing facilities in Spain. The results of Indas operations have been included in the Personal Care reportable segment as of January 2, 2014. The purchase price was \$546 million ( 399 million) in cash, net of cash acquired of \$46 million ( 34 million). The acquisition was accounted for as a business combination under the acquisition method of accounting, in accordance with the Business Combinations Topic of FASB Accounting Standards Codification ( ASC ).

The total purchase price was allocated to tangible and intangible assets acquired and liabilities assumed based on the Company's estimates of their fair value.

The table below illustrates the purchase price allocation:

|   |            |
|---|------------|
| <b>Fair value of net assets acquired at the date of acquisition</b> |            |
| Receivables   | \$ 101     |
| Inventory   | 28         |
| Income and other taxes receivable                                   | 3          |
| Property, plant and equipment                                       | 72         |
| Intangible assets   |            |
| <i>Customer relationships</i> <sup>(1)</sup>                        | 142        |
| <i>Trade names</i> <sup>(2)</sup>                                   | 140        |
| <i>Catalog rights</i> <sup>(2)</sup>                                | 46         |
|   | 328        |
| Goodwill  | 234        |
| Deferred income tax assets  | 16         |
| <b>Total assets</b>   | <b>782</b> |
| <b>Less: Liabilities</b>  |            |
| Trade and other payables  | 71         |
| Income and other taxes payable                                      | 3          |
| Long-term debt (including short-term portion)                       | 42         |

|   |            |
|---|------------|
| Deferred income tax liabilities                                     | 119        |
| Other liabilities and deferred credits                              | 1          |
| <b>Total liabilities</b>  | <b>236</b> |
| <b>Fair value of net assets acquired at the date of acquisition</b> | <b>546</b> |

(1) The useful life of Customer relationships acquired is between 10-20 years.

(2) Indefinite useful life.

Goodwill represents the future economic benefit arising from other assets acquired that could not be individually identified and separately recognized. The goodwill is attributable to the general reputation of the business, the assembled workforce, the expected synergies and the expected future cash flows of the business. Disclosed goodwill is not deductible for tax purposes.

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**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2015**

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

**(UNAUDITED)**

**NOTE 4.**

**DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT**

**HEDGING PROGRAMS**

The Company is exposed to market risk, such as changes in currency exchange rates, commodity prices, and interest rates. To the extent the Company decides to manage the volatility related to these exposures, the Company may enter into various financial derivatives that are accounted for under the derivatives and hedging guidance. These transactions are governed by the Company's hedging policies which provide direction on acceptable hedging activities, including instrument type and acceptable counterparty exposure.

Upon inception, the Company formally documents the relationship between hedging instruments and hedged items. At inception and quarterly thereafter, the Company formally assesses whether the financial instruments used in hedging transactions are effective at offsetting changes in either the cash flow or the fair value of the underlying exposures. The ineffective portion of the qualifying instrument is immediately recognized to earnings. The amount of ineffectiveness recognized was immaterial for all years presented. The Company does not hold derivative financial instruments for trading purposes.

**CREDIT RISK**

The Company is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, the Company reviews new customers' credit history before granting credit and conducts regular reviews of existing customers' credit performance. As of March 31, 2015, one of Domtar's Pulp and Paper segment customers located in the United States represented 13% (\$88 million) (2014 - 10% (\$64 million)) of the Company's receivables.

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

**INTEREST RATE RISK**

The Company is exposed to interest rate risk arising from fluctuations in interest rates on its cash and cash equivalents, bank indebtedness, bank credit facility and long-term debt. The Company's objective in managing exposure to interest rate changes is to minimize the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs. The Company may manage this interest rate exposure through the use of derivative instruments such as interest rate swap contracts, whereby it agrees to exchange the difference between fixed and variable interest amounts calculated by reference to an agreed upon notional principal amount. On December 18, 2014, the Company entered into a \$100 million notional 2.5 year fixed to floating interest rate swap to receive fixed (1.0225%) and pay the 3 month LIBOR. This swap was designated as a fair value hedge for a portion of its 10.75% notes due June 2017. The changes in fair value of both the hedging and the hedged item are immediately recognized in interest expense. Gains (losses) related to the ineffectiveness portion of the hedges were not material for this

reporting period.

**COST RISK**

Cash flow hedges:

The Company purchases natural gas at the prevailing market price at the time of delivery. To reduce the impact on cash flow and earnings due to pricing volatility, the Company may utilize derivatives to fix the price of forecasted natural gas purchases. The changes in the fair value on qualifying instruments are included in Accumulated other comprehensive loss to the extent effective, and reclassified into Cost of sales in the period during which the hedged transaction affects earnings. Current contracts are used to hedge a portion of forecasted purchases over the next three years.

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**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2015**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**

The following table presents the volumes under derivative financial instruments for natural gas contracts outstanding as of March 31, 2015 to hedge forecasted purchases:

| Commodity           | Notional contractual quantity<br>under derivative<br>contracts | Notional contractual value<br>under derivative<br>contracts<br>(in millions of<br>dollars) | Percentage of forecasted<br>purchases<br>under<br>derivative<br>contracts |
|---------------------|--|--|---|
| Natural Gas         |  |  |   |
| 2015 <sup>(1)</sup> | 7,425,000  | MMBTU <sup>(2)</sup> \$ 31   | 54%   |
| 2016                | 8,775,000  | MMBTU <sup>(2)</sup> \$ 35   | 42%   |
| 2017                | 2,700,000  | MMBTU <sup>(2)</sup> \$ 11   | 13%   |

<sup>(1)</sup> Represents the remaining nine months of 2015

<sup>(2)</sup> MMBTU: Millions of British thermal units

The natural gas derivative contracts were fully effective as of March 31, 2015. There were no amounts reflected in the Consolidated Statements of Earnings and Comprehensive (Loss) Income for the three months ended March 31, 2015 resulting from hedge ineffectiveness (2014 nil).

**FOREIGN CURRENCY RISK**

Cash flow hedges:

The Company has manufacturing operations in the United States, Canada and Europe. As a result, it is exposed to movements in foreign currency exchange rates in Canada and Europe. Moreover, certain assets and liabilities are denominated in currencies other than the U.S. dollar and are exposed to foreign currency movements. Accordingly, the Company's earnings are affected by increases or decreases in the value of the Canadian dollar and the European currencies. The Company's European subsidiaries are also exposed to movements in foreign currency exchange rates on transactions denominated in a currency other than their Euro functional currency. The Company's risk management policy allows it to hedge a significant portion of its exposure to fluctuations in foreign currency exchange rates for periods up to three years. The Company may use derivative financial instruments (currency options and foreign exchange forward contracts) to mitigate its exposure to fluctuations in foreign currency exchange rates.

Derivatives are used to hedge forecasted purchases in Canadian dollars by its Canadian subsidiary over the next 24 months. Derivatives are used to hedge forecasted sales by its US subsidiaries in Euros over the next 21 months and British pounds over the next nine months. Derivatives are also used to hedge forecasted sales in British pounds and Norwegian krone and forecasted purchases of Swedish krona over the next 12 months and forecasted purchases in US dollars over the next 21 months by its European subsidiaries. Such derivatives are designated as cash flow hedges. The changes in the fair value on qualifying instruments are included in Accumulated other comprehensive loss to the extent effective,

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and reclassified into Sales or Cost of sales in the period during which the hedged transaction affects earnings.

**Table of Contents****DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2015****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**

The following table presents the currency values under significant contracts pursuant to currency options outstanding as of March 31, 2015 to hedge forecasted purchases and sales:

| Currency exposure hedged | Business Segment | Year | Notional contractual value | Percentage of forecasted net exposures under contracts | Protection rate | Obligation rate |
|--------------------------|------------------|------|----------------------------|--|-----------------|-----------------|
|                          |                  | 2015 |                            |  |                 |                 |
| CDN/USD                  | Pulp and Paper   |      | 300 CDN                    | 52%  | 1 USD = 1.1026  | 1 USD = 1.1373  |
| USD/Euro                 | Personal Care    |      | 44 USD                     | 77%  | 1 Euro = 1.3135 | 1 Euro = 1.3155 |
| Euro/USD                 | Pulp and Paper   |      | 34 EUR                     | 76%  | 1 Euro = 1.1572 | 1 Euro = 1.1572 |
|                          |                  | 2016 |                            |  |                 |                 |
| CDN/USD                  | Pulp and Paper   |      | 240 CDN                    | 31%  | 1 USD = 1.1292  | 1 USD = 1.1739  |
| USD/Euro                 | Personal Care    |      | 40 USD                     | 53%  | 1 Euro = 1.0722 | 1 Euro = 1.1918 |
| Euro/USD                 | Pulp and Paper   |      | 15 EUR                     | 25%  | 1 Euro = 1.1629 | 1 Euro = 1.1629 |
|                          |                  | 2017 |                            |  |                 |                 |
| CDN/USD                  | Pulp and Paper   |      | 45 CDN                     | 6%   | 1 USD = 1.2042  | 1 USD = 1.2731  |

The foreign exchange derivative contracts were fully effective as of March 31, 2015. There were no amounts reflected in the Consolidated Statements of Earnings and Comprehensive (Loss) Income for the three months ended March 31, 2015 resulting from hedge ineffectiveness (2014 - nil).

**FAIR VALUE MEASUREMENT**

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

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



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**NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**

The following tables present information about the Company's financial assets and financial liabilities measured at fair value on a recurring basis (except Long-term debt, see (c) below) at March 31, 2015 and December 31, 2014, in accordance with the accounting standards for fair value measurements and disclosures and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

| Fair Value of financial instruments at:  | March 31,<br>2015<br>\$ | Quoted prices in<br>active markets for<br>identical<br>assets<br>(Level 1)<br>\$ | Significant<br>observable<br>inputs<br>(Level 2)<br>\$ | Significant<br>unobservable<br>inputs<br>(Level 3)<br>\$ | Balance sheet classification               |
|--|-------------------------|--|--|--|--|
| <b>Derivatives designated under the Derivatives and Hedging Topic of FASB ASC:</b> |                         |  |  |  |  |
| <b>Asset derivatives</b>   |                         |  |  |  |  |
| Currency derivatives   | 14                      |  | 14   |  | (a) Prepaid expenses                       |
| Currency derivatives   | 4                       |  | 4  |  | (a) Other assets                           |
| <b>Total Assets</b>  | <b>18</b>               |  | <b>18</b>  |  |  |
| <b>Liabilities derivatives</b>   |                         |  |  |  |  |
| Currency derivatives   | 36                      |  | 36   |  | (a) Trade and other payables               |
| Currency derivatives   |                         |  |  |  | (a) Other liabilities and deferred credits |
|  | 15                      |  | 15   |  |  |
| Natural gas swap contracts   | 12                      |  | 12   |  | (a) Trade and other payables               |
| Natural gas swap contracts   |                         |  |  |  | (a) Other liabilities and deferred credits |
|  | 8                       |  | 8  |  |  |
| <b>Total Liabilities</b>   | <b>71</b>               |  | <b>71</b>  |  |  |
| <b>Other Instruments:</b>  |                         |  |  |  |  |
| Asset backed notes ( ABN )   | 10                      | 10   |  |  | Accounts receivable                        |
| Asset backed notes   | 1                       |  |  | 1  | (b) Other assets                           |
| Long-term debt   | 1,485                   |  | 1,485  |  | (c) Long-term debt                         |

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The cumulative loss recorded in Other comprehensive (loss) income relating to natural gas contracts of \$20 million at March 31, 2015, will be recognized in Cost of sales upon maturity of the derivatives over the next 33 months at the then prevailing values, which may be different from those at March 31, 2015.

The cumulative loss recorded in Other comprehensive (loss) income relating to currency options and forwards hedging forecasted purchases of \$33 million at March 31, 2015, will be recognized in Cost of sales or Sales upon maturity of the derivatives over the next 24 months at the then prevailing values, which may be different from those at March 31, 2015.

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**NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**

| Fair Value of financial instruments at:  | December 31,<br>2014<br>\$ | Quoted prices in<br>active markets for<br>identical<br>assets<br>(Level 1)<br>\$ | Significant<br>observable<br>inputs<br>(Level 2)<br>\$ | Significant<br>unobservable<br>inputs<br>(Level 3)<br>\$ | Balance sheet classification               |
|--|----------------------------|--|--|--|--|
| <b>Derivatives designated under the Derivatives and Hedging Topic of FASB ASC:</b> |                            |  |  |  |  |
| <b>Asset derivatives</b>   |                            |  |  |  |  |
| Currency derivatives   | 7                          |  | 7  |  | (a) Prepaid expenses                       |
| Currency derivatives   | 3                          |  | 3  |  | (a) Other assets                           |
| <b>Total Assets</b>  | <b>10</b>                  |  | <b>10</b>  |  |  |
| <b>Liabilities derivatives</b>   |                            |  |  |  |  |
| Currency derivatives   | 14                         |  | 14   |  | (a) Trade and other payables               |
| Currency derivatives   |                            |  |  |  | (a) Other liabilities and deferred credits |
| Natural gas swap contracts   | 9                          |  | 9  |  |  |
| Natural gas swap contracts   | 13                         |  | 13   |  | (a) Trade and other payables               |
| Natural gas swap contracts   |                            |  |  |  | (a) Other liabilities and deferred credits |
|  | 6                          |  | 6  |  |  |
| <b>Total Liabilities</b>   | <b>42</b>                  |  | <b>42</b>  |  |  |
| <b>Other Instruments:</b>  |                            |  |  |  |  |
| Asset backed notes   | 11                         |  | 10   | 1  | (b) Other assets                           |
| Long-term debt   | 1,475                      |  | 1,475  |  | (c) Long-term debt                         |

- (a) Fair value of the Company's derivatives is classified under Level 2 (inputs that are observable; directly or indirectly) as it is measured as follows:
- For currency derivatives: Fair value is measured using techniques derived from the Black-Scholes pricing model. Interest rates, forward market rates and volatility are used as inputs for such valuation techniques.
  - For natural gas contracts: Fair value is measured using the discounted difference between contractual rates and quoted market future rates.

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- (b) ABN are reported at fair value utilizing Level 2 or Level 3 inputs. Fair value of ABN reported under Level 2 is based on current market quotes. Fair value of ABN reported under Level 3 is based on the value of the collateral investments held in the conduit issuer, reduced by the negative value of credit default derivatives, with an additional discount applied for illiquidity. These ABN are held outside of the Company's pension plans.
- (c) Fair value of the Company's long-term debt is measured by comparison to market prices of its debt. In accordance with US GAAP, the Company's long-term debt is not carried at fair value on the Consolidated Balance Sheets at March 31, 2015 and December 31, 2014. However, fair value disclosure is required. The carrying value of the Company's long-term debt is \$1,348 million and \$1,350 million at March 31, 2015 and December 31, 2014, respectively. Due to their short-term maturity, the carrying amounts of cash and cash equivalents, receivables, bank indebtedness, trade and other payables and income and other taxes approximate their fair values.

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**NOTE 5.**

**EARNINGS PER COMMON SHARE**

On April 30, 2014, the Company's Board of Directors approved a 2-for-1 split of its common stock to be effected through a stock dividend. Shareholders of record on June 10, 2014 were entitled to receive one additional share for every share they owned on that date.

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

|  | <b>For the three months ended</b> |                           |
|--|-----------------------------------|---------------------------|
|  | <b>March 31,<br/>2015</b>         | <b>March 31,<br/>2014</b> |
| Net earnings   | <b>\$ 36</b>                      | <b>\$ 39</b>              |
| Weighted average number of common and exchangeable shares outstanding (millions)         | <b>63.8</b>                       | 64.9                      |
| Effect of dilutive securities (millions)   | <b>0.1</b>                        | 0.1                       |
| Weighted average number of diluted common and exchangeable shares outstanding (millions) | <b>63.9</b>                       | 65.0                      |
| Basic net earnings per common share (in dollars)   | <b>\$ 0.56</b>                    | \$ 0.60                   |
| Diluted net earnings per common share (in dollars)                                       | <b>\$ 0.56</b>                    | \$ 0.60                   |

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

|         | <b>March 31,<br/>2015</b> | <b>March 31,<br/>2014</b> |
|---------|---------------------------|---------------------------|
| Options | <b>139,007</b>            | 337,272                   |

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**NOTE 6.**

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

**DEFINED CONTRIBUTION PLANS**

The Company has several defined contribution plans and two Canadian multiemployer plans. The pension expense under these plans is equal to the Company's contribution. For the three months ended March 31, 2015, the related pension expense was \$8 million (2014 -\$8 million).

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

The Company sponsors both contributory and non-contributory U.S. and non-U.S. defined benefit pension plans. Non-unionized employees in Canada joining the Company after June 1, 2000 participate in a defined contribution pension plan. Salaried employees in the U.S. joining the Company after January 1, 2008 participate in a defined contribution pension plan. Most unionized employees in the U.S. and all U.S. non-hourly employees that are not grandfathered under the existing defined benefit pension plans, participate in a defined contribution pension plan for future service. The Company also sponsors a number of other post-retirement benefit plans for eligible U.S. and non-U.S. employees; the plans are unfunded and include life insurance programs and medical and dental benefits. The Company also provides supplemental unfunded defined benefit pension plans and supplemental unfunded defined contribution pension plans to certain senior management employees.

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

|  | For the three months ended |  |                  |  |
|--|----------------------------|--|------------------|--|
|  | March 31, 2015             |  | March 31, 2014   |  |
|  | Pension<br>plans           | Other post-<br>retirement<br>benefit plans | Pension<br>plans | Other post-<br>retirement<br>benefit plans |
|  | \$                         | \$   | \$               | \$   |
| Service cost                             | 9                          | 1  | 9                | 1  |
| Interest expense                         | 16                         | 1  | 20               | 1  |
| Expected return on plan assets           | (24)                       |  | (26)             |  |
| Amortization of net actuarial loss       | 2                          |  | 2                |  |
| Amortization of prior year service costs | 1                          |  | 1                |  |
| Net periodic benefit cost                | 4                          | 2  | 6                | 2  |

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The Company contributed \$3 million for the three months ended March 31, 2015 (2014 \$10 million) to the pension plans and \$1 million to the other post-retirement benefit plans (2014 nil).

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**NOTE 7.**

**OTHER OPERATING LOSS (INCOME), NET**

Other operating loss (income), net is an aggregate of both recurring and occasional loss or income items and, as a result, can fluctuate from period to period. The Company's other operating loss (income), net includes the following:

|   | <b>For the three months ended<br/>March 31,<br/>2015</b> | <b>March 31,<br/>2014</b> |
|---|--|---------------------------|
|   | <b>\$</b>  | <b>\$</b>                 |
| Gain on sale of property, plant and equipment | (1)  |                           |
| Bad debt expense                              | 5  | 1                         |
| Foreign exchange gain                         |  | (3)                       |
| Other   | 1  |                           |
| Other operating loss (income), net            | 5  | (2)                       |

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**NOTE 8.**

**INCOME TAXES**

For the first quarter of 2015, the Company's income tax expense was \$9 million, consisting of a current income tax expense of \$24 million and a deferred income tax benefit of \$15 million. This compares to a tax expense of \$15 million for the first quarter of 2014, consisting of a current income tax expense of \$15 million and no deferred income tax expense. The Company received income tax refunds, net of payments, of \$23 million during the first quarter of 2015. The effective tax rate was 20% compared with an effective tax rate of 28% in the first quarter of 2014. The effective tax rate for the first quarter of 2015 was impacted by the impairment and write-down of property, plant, and equipment charges occurring in a high-tax jurisdiction.

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**NOTE 9.**

**INVENTORIES**

The following table presents the components of inventories:

|                                    | March 31,<br>2015<br>\$ | December 31,<br>2014<br>\$ |
|------------------------------------|-------------------------|----------------------------|
| Work in process and finished goods | 388                     | 395                        |
| Raw materials                      | 122                     | 123                        |
| Operating and maintenance supplies | 194                     | 196                        |
|                                    | <b>704</b>              | <b>714</b>                 |

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**NOTE 10.**

**GOODWILL**

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

|   | <b>March 31, 2015</b> |
|---|-----------------------|
| Balance at December 31, 2014                    | \$ 567                |
| Effect of foreign currency exchange rate change | (30)                  |
| Balance at end of period                        | 537                   |

The goodwill at March 31, 2015 is entirely related to the Personal Care segment.

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**NOTE 11.**

**INTANGIBLE ASSETS**

The following table presents the components of intangible assets:

|  | Estimated useful lives<br>(in years) | March 31, 2015                 |                                   |            | December 31, 2014              |                                   |           |
|--|--------------------------------------|--------------------------------|-----------------------------------|------------|--------------------------------|-----------------------------------|-----------|
|  |                                      | Gross carrying<br>amount<br>\$ | Accumulated<br>amortization<br>\$ | Net<br>\$  | Gross carrying<br>amount<br>\$ | Accumulated<br>amortization<br>\$ | Net<br>\$ |
| <b>Intangible assets subject to amortization</b>     |                                      |                                |                                   |            |                                |                                   |           |
| Water rights   | 40                                   | 8                              | (1)                               | 7          | 8                              | (1)                               | 7         |
| Customer relationships                               | 10 - 40                              | 352                            | (34)                              | 318        | 374                            | (32)                              | 342       |
| Technology   | 7 - 20                               | 8                              | (2)                               | 6          | 8                              | (2)                               | 6         |
| Non-Compete  | 9                                    | 1                              |                                   | 1          | 1                              |                                   | 1         |
| License rights                                       | 12                                   | 28                             | (4)                               | 24         | 29                             | (4)                               | 25        |
|  |                                      | <b>397</b>                     | <b>(41)</b>                       | <b>356</b> | 420                            | (39)                              | 381       |
| <b>Intangible assets not subject to amortization</b> |                                      |                                |                                   |            |                                |                                   |           |
| Trade names  |                                      | 214                            |                                   | 214        | 233                            |                                   | 233       |
| License rights                                       |                                      | 6                              |                                   | 6          | 6                              |                                   | 6         |
| Catalog rights                                       |                                      | 36                             |                                   | 36         | 41                             |                                   | 41        |
| <b>Total</b>   |                                      | <b>653</b>                     | <b>(41)</b>                       | <b>612</b> | 700                            | (39)                              | 661       |

Amortization expense related to intangible assets for the three months ended March 31, 2015 was \$5 million (2014 \$5 million).

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

|   | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|------|------|------|------|------|
|   | \$   | \$   | \$   | \$   | \$   |
| Amortization expense related to intangible assets | 19   | 19   | 18   | 18   | 18   |



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**NOTE 12.**

**CLOSURE AND RESTRUCTURING COSTS AND LIABILITY AND IMPAIRMENT**

**AND WRITE-DOWN OF PROPERTY, PLANT AND EQUIPMENT**

The Company regularly reviews its overall production capacity with the objective of aligning its production capacity with anticipated long-term demand, which in some cases could result in closure or impairment costs being recorded in earnings.

As a result of the Company's previous withdrawal from its U.S. multiemployer plans, the total provision for the withdrawal liabilities is \$60 million at March 31, 2015. Of the \$60 million provision, \$14 million of this amount has a small amount of measurement uncertainty as the Company remains exposed to potential additional withdrawal liabilities to the fund in the event of a mass withdrawal occurring anytime within the next two years.

*Ashdown, Arkansas mill*

On December 10, 2014, the Company announced that its Board of Directors approved a \$160 million capital project to convert a paper machine at the Ashdown, Arkansas mill to a high quality fluff pulp line used in absorbent applications such as baby diapers, feminine hygiene and adult incontinence products. The planned conversion is expected to come online by the third quarter of 2016 and will allow for the production of up to 516,000 metric tons of fluff pulp per year once the machine is in full operation. The project will also result in the permanent reduction of 364,000 short tons of annual uncoated freesheet production capacity in the second quarter of 2016.

The conversion work is expected to commence during the second quarter of 2016 and the fluff pulp line is scheduled to startup by the third quarter of 2016. The cost of conversion will be approximately \$160 million of which \$40 million is expected to be invested in 2015 and \$120 million in 2016. The Company will also invest \$40 million in a pulp bale line that will provide flexibility to manufacture papergrade softwood pulp, contingent on market conditions.

The aggregate pre-tax earnings charge in connection with this conversion is estimated to be \$120 million which includes an estimated \$117 million in non-cash charges relating to accelerated depreciation of the carrying amounts of the manufacturing equipment as well as the write-off of related spare parts. Of the estimated pre-tax charge of \$120 million, \$3 million relates to estimated cash severance, employee benefits and training. Of the estimated total pre-tax charge of \$120 million, \$113 million is expected to be incurred during 2015 and 2016. As a result of the 2014 fourth quarter decision to convert a paper machine to a fluff pulp line at its Ashdown, Arkansas mill, the Company recorded in the first quarter of 2015 \$19 million of accelerated depreciation under Impairment and write-down of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive (Loss) Income.

*Other costs*

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During the first quarter of 2015, other costs related to previous and ongoing closures include \$1 million of severance and termination costs related to Personal Care.

During the first quarter of 2014, other costs related to previous and ongoing closures include \$1 million of severance and termination costs related to Personal Care.

At March 31, 2015, the Company's provision for closure and restructuring costs is \$3 million. This provision is comprised of severance and termination costs of \$2 million in the Pulp and Paper segment and \$1 million in the Personal Care segment.

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**NOTE 13.****CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT**

The following table presents the changes in Accumulated other comprehensive loss by component<sup>(1)</sup> for the periods ended March 31, 2015 and December 31, 2014:

|  | Net derivative<br>gains<br>(losses)<br>on cash<br>flow<br>hedges | Pension<br>items <sup>(2)</sup> | Post-<br>retirement<br>benefit items <sup>(2)</sup> | Foreign<br>currency<br>items | Total |
|--|--|---------------------------------|---|------------------------------|-------|
| Balance at December 31, 2013                                   |  | (210)                           | (7)   | 152                          | (65)  |
| Natural gas swap contracts                                     | (10)   | N/A                             | N/A   | N/A                          | (10)  |
| Currency options   | (15)   | N/A                             | N/A   | N/A                          | (15)  |
| Forward contracts  | 2  | N/A                             | N/A   | N/A                          | 2     |
| Net gain   | N/A  | (4)                             | (6)   | N/A                          | (10)  |
| Foreign currency items   | N/A  | N/A                             | N/A   | (200)                        | (200) |
| Other comprehensive loss before reclassifications              | (23)   | (4)                             | (6)   | (200)                        | (233) |
| Amounts reclassified from Accumulated other comprehensive loss | 8  | 22                              |   |                              | 30    |
| Net current period other comprehensive (loss) income           | (15)   | 18                              | (6)   | (200)                        | (203) |
| <b>Balance at December 31, 2014</b>                            | (15)   | (192)                           | (13)  | (48)                         | (268) |
| Balance at December 31, 2014                                   | (15)   | (192)                           | (13)  | (48)                         | (268) |
| Natural gas swap contracts                                     | (3)  | N/A                             | N/A   | N/A                          | (3)   |
| Currency options   | (21)   | N/A                             | N/A   | N/A                          | (21)  |
| Forward contracts  | 6  | N/A                             | N/A   | N/A                          | 6     |
| Net gain   | N/A  |                                 |   | N/A                          |       |
| Foreign currency items   | N/A  | N/A                             | N/A   | (167)                        | (167) |

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|  |      |       |       |              |
|--|------|-------|-------|--------------|
| Other comprehensive loss before reclassifications              | (18) |       | (167) | <b>(185)</b> |
| Amounts reclassified from Accumulated other comprehensive loss | 5    | 2     |       | 7            |
| Net current period other comprehensive (loss) income           | (13) | 2     | (167) | <b>(178)</b> |
| <b>Balance at March 31, 2015</b>                               | (28) | (190) | (13)  | <b>(446)</b> |

- (1) All amounts are after tax. Amounts in parenthesis indicate losses.  
(2) The accrued benefit obligation is actuarially determined on an annual basis as of December 31.

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**NOTE 13. CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT (CONTINUED)**

The following tables present reclassifications out of Accumulated other comprehensive loss:

| <b>Details about Accumulated other<br/>comprehensive loss components</b> | <b>Amount reclassified from<br/>Accumulated other<br/>comprehensive loss<br/>For the three months ended</b> |                       |
|--|---|-----------------------|
|  | <b>March 31, 2015</b>   | <b>March 31, 2014</b> |
| Net derivative gains (losses) on cash flow hedges                        |   |                       |
| Natural gas swap contracts   | <b>4</b>  | (2) <sup>(1)</sup>    |
| Currency options and forwards  | <b>5</b>  | 6 <sup>(1)</sup>      |
| <b>Total before tax</b>  | <b>9</b>  | 4                     |
| Tax expense  | <b>(4)</b>  | (2)                   |
| <b>Net of tax</b>  | <b>5</b>  | 2                     |
| Amortization of defined benefit pension items                            |   |                       |
| Amortization of net actuarial loss and prior year service cost           | <b>3</b>  | 3 <sup>(2)</sup>      |
| Tax expense  | <b>(1)</b>  | (1)                   |
| <b>Net of tax</b>  | <b>2</b>  | 2                     |

(1) These amounts are included in Cost of Sales in the Consolidated Statements of Earnings and Comprehensive (Loss) Income.

(2) These amounts are included in the computation of net periodic benefit cost. Refer to Note 6 Pension plans and other post-retirement benefit plans for additional details.

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**NOTE 14.**

**SHAREHOLDERS EQUITY**

On February 23, 2015, the Company's Board of Directors approved a quarterly dividend of \$0.40 per share to be paid to holders of the Company's common stock. Total dividends of approximately \$26 million were paid on April 15, 2015 to shareholders of record on April 2, 2015.

On May 5, 2015, the Company's Board of Directors approved a quarterly dividend of \$0.40 per share to be paid to holders of the Company's common stock. This dividend is to be paid on July 15, 2015, to shareholders of record on July 2, 2015.

**STOCK REPURCHASE PROGRAM**

The Company's Board of Directors has authorized a stock repurchase program (the Program) of up to \$1 billion of Domtar Corporation's common stock. On February 23, 2015, the Company's Board of Directors approved an increase to the Program from \$1 billion to \$1.3 billion. Under the Program, the Company is authorized to repurchase from time to time shares of its outstanding common stock on the open market or in privately negotiated transactions in the United States. The timing and amount of stock repurchases will depend on a variety of factors, including the market conditions as well as corporate and regulatory considerations. The Program may be suspended, modified or discontinued at any time and the Company has no obligation to repurchase any amount of its common stock under the Program. The Program has no set expiration date. The Company repurchases its common stock, from time to time, in part to reduce the dilutive effects of stock options, awards, and to improve shareholders' returns.

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

During the first quarter of 2015, the Company repurchased 340,844 shares at an average price of \$39.20 for a total cost of \$13 million.

During the first quarter of 2014, the Company did not repurchase any shares under the Program.

Since the inception of the Program, the Company has repurchased 23,678,824 shares at an average price of \$39.21 for a total cost of \$929 million. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

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

An action was commenced by Seaspan International Ltd. ( "Seaspan" ) in the Supreme Court of British Columbia, on March 31, 1999 against the Company and others with respect to alleged contamination of Seaspan's site bordering Burrard Inlet in North Vancouver, British Columbia, including contamination of sediments in Burrard Inlet, due to the presence of creosote and heavy metals. Beyond the filing of preliminary pleadings, no steps have been taken by the parties in this action. On February 16, 2010, the government of British Columbia issued a Remediation Order to Seaspan and the Company ( "responsible persons" ) in order to define and implement an action plan to address soil, sediment and groundwater issues. This Order was appealed to the Environmental Appeal Board ( "Board" ) on March 17, 2010 but there is no suspension in the execution of this Order unless the Board orders otherwise. The relevant government authorities selected a remediation approach on July 15, 2011, and on January 8, 2013, the same authorities decided that each responsible persons' implementation plan is satisfactory and that the responsible persons should decide which plan is to be used. Most of the remaining appeals that were to be heard before the Board were abandoned by the parties during the course of the Board proceedings which were held in the fall of 2013. Seaspan and Domtar have selected a remedial plan and have applied to the Vancouver Fraser Port Authority for permitting approval. The Company has recorded an environmental reserve to address its estimated exposure. The possible loss in excess of the reserve is not considered to be material for this matter.

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

|   | <b>March 31, 2015</b> |
|---|-----------------------|
|   | <b>\$</b>             |
| Balance at beginning of period                  | 60                    |
| Additions                                       | 1                     |
| Environmental spending                          | (1)                   |
| Effect of foreign currency exchange rate change | (4)                   |
| Balance at end of period                        | 56                    |



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**NOTE 15. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

The Company is also a party to various proceedings relating to the cleanup of hazardous waste sites under the Comprehensive Environmental Response Compensation and Liability Act, commonly known as Superfund, and similar state laws. The U.S. Environmental Protection Agency (EPA) and/or various state agencies have notified the Company that it may be a potentially responsible party with respect to other hazardous waste sites as to which no proceedings have been instituted against the Company. The Company continues to take remedial action under its Care and Control Program at its former wood preserving sites, and at a number of operating sites 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, if and when applicable, the allocation of liability among potentially responsible parties.

*Climate change regulation*

In response to the Kyoto Protocol, which calls for reductions of certain emissions that may contribute to increases in atmospheric greenhouse gas (GHG) concentrations, various international, national and local laws have been proposed or implemented focusing on reducing GHG emissions. These actual or proposed laws do or may apply in the jurisdictions where the Company currently has, or may have in the future, manufacturing facilities or investments.

In the United States, Congress has considered legislation to reduce emissions of GHGs. Although the legislation has not passed, the U.S. government is promulgating regulations under the existing Clean Air Act to reduce GHG emissions from public utilities and certain other emitters. The EPA has adopted and implemented GHG permitting requirements for certain new sources and modifications of existing industrial facilities and has proposed GHG performance standards for newly constructed, reconstructed and modified electric utilities. The EPA has also relied on the existing Clean Air Act to propose a Clean Power Plan that will set emission guidelines for existing electric utilities and require states to develop plans for reducing GHG emissions by making significant changes to the energy resources utilized within the state. The EPA is developing a biogenic carbon accounting framework to account for carbon dioxide emissions from biomass fuels for Clean Air Act permitting and regulatory purposes. The EPA references this framework in the proposals addressing GHG performance standards for the electric utilities. Furthermore, several states are already regulating GHG emissions from public utilities and certain other significant emitters, primarily through regional GHG cap-and-trade programs or renewable energy requirements.

The U.S. Supreme Court held on June 23, 2014 that the EPA had exceeded its statutory authority in establishing its GHG permitting program. Specifically, the Court determined that the EPA could not impose GHG permitting requirements on a source unless that source had already triggered permitting requirements for other non-GHG pollutants. However, for sources already subject to permitting, the Court held that the Clean Air Act did not preclude the EPA from requiring those sources to install best available control technology for GHGs.

Passage of GHG legislation by Congress or individual states, or the adoption of regulations by the EPA or analogous state agencies, that restrict emissions of GHGs in areas in which the Company conducts business could have a variety of impacts upon the Company, including requiring it to implement GHG reduction programs or to pay taxes or other fees with respect to its GHG emissions. This, in turn, could increase the Company's operating costs and capital spending. The Company does not expect to be disproportionately affected by these measures compared with other pulp and paper producers in the United States.

The Government of Canada has committed to reducing Canada's greenhouse gases by 17 percent from 2005 levels by 2020. A sector-by-sector approach is being used to set performance standards to reduce greenhouse gases. The Government of Canada has implemented regulations intended to regulate emissions from motor vehicles and has enacted regulations to reduce GHG emissions from coal-fired electrical generators

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which are scheduled to become effective July 1, 2015. Proposed regulations relating to GHG emissions from the oil and gas sector are currently in consultation and are expected to come into force in 2016. Performance standards for industrial sectors will also be developed. The pulp and paper sector is currently undergoing review. The Company does not expect the performance of its facilities to be disproportionately affected by these future measures compared with other pulp and paper producers in Canada.

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**NOTE 15. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

The province of Quebec initiated a GHG cap-and-trade system on January 1, 2012. Reduction targets for Quebec became effective January 1, 2013. The Company does not expect the cost of compliance will have a material impact on the Company's financial position, results of operations or cash flows. British Columbia imposed a carbon tax in 2008, which applies to the purchase of fossil fuels within the province. There are currently no other federal or provincial statutory or regulatory obligations that affect the emission of GHGs for the Company's pulp and paper operations elsewhere in Canada. The Province of Ontario is expected to initiate development of a regulatory program, including carbon pricing policies for GHG emission reductions in 2015.

While it is likely that there will be increased regulation relating to GHG emissions in the future, at this time it is not possible to estimate either a timetable for the promulgation or implementation of any new regulations or the Company's cost of compliance to said regulations. The Company does not anticipate to be disproportionately affected or impacted by these measures.

*Industrial Boiler Maximum Achievable Control Technology Standard ( MACT )*

The EPA published in the Federal Register on January 31, 2013, for facilities that are major sources for Hazardous Air Pollutants, a new set of standards related to emissions from boilers and process heaters included in some of the Company's manufacturing processes. These standards are generally referred to as Boiler MACT and seek to require reductions in the emission of certain hazardous air pollutants or surrogates of hazardous air pollutants. The Company is developing plans to bring facilities affected by the Boiler MACT rule into compliance by the January 2016 regulatory deadline for major sources. The Company expects that the capital cost required to comply with the Boiler MACT rules is approximately \$15 million. Boiler MACT rules are being litigated. Changes to the rule resulting from the litigation could affect the current expected capital cost for compliance and could also affect future operating costs.

The EPA has agreed to reconsider a limited number of issues in the most recent Boiler MACT rule, and elements of the EPA's rule have been legally challenged. Since the consequences of these activities cannot be predicted, adjustments to compliance plans may be needed to accommodate any changes to the final rule.

**CONTINGENCIES**

In the normal course of operations, the Company becomes involved in various legal actions mostly related to contract disputes, patent infringements, environmental and product warranty claims, and labor issues. While the final outcome with respect to actions outstanding or pending at March 31, 2015, cannot be predicted with certainty, it is management's opinion that their resolution will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

*Spanish Competition Investigation*

In September 2014, following preliminary inquiries commenced in January 2014, Spain's National Commission of Markets and Competition initiated a formal investigation of several companies and their parent companies, including Indas (a subsidiary of the Company, acquired on January 2, 2014), and two of its affiliates, as well as an industry association, Federacion Espanola de Empresas de Tecnologia Sanitaria ( FENIN ), with respect to possible unlawful conduct, consisting of fixing prices, commercial terms and dispensation of heavy adult incontinence products in the Spanish market. The activities under investigation predate the acquisition of Indas by the Company. The sellers of Indas made

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representations and warranties to the Company in the purchase agreement regarding, among other things, Indas and its subsidiary's compliance with competition laws. The liability retained by the sellers is backed by bank guarantees, and limited insurance coverage has been purchased with regards to excess liability. As a result, while the final outcome with respect to the investigation cannot be predicted with certainty, it is management's opinion that its resolution will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

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**NOTE 15. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

**INDEMNIFICATIONS**

In the normal course of business, the Company offers indemnifications relating to the sale of its businesses and real estate. In general, these indemnifications may relate to claims from past business operations, the failure to abide by covenants and the breach of representations and warranties included in the sales agreements. Typically, such representations and warranties relate to taxation, environmental, product and employee matters. The terms of these indemnification agreements are generally for an unlimited period of time. At March 31, 2015, the Company is unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provision has been recorded. These indemnifications have not yielded a significant expense in the past.

*Pension Plans*

The Company has indemnified and held harmless the trustees of its pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions from the Company or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. At March 31, 2015 the Company has not recorded a liability associated with these indemnifications, as it does not expect to make any payments pertaining to these indemnifications.

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**NOTE 16.**

**SEGMENT DISCLOSURES**

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

**Pulp and Paper Segment** comprises the design, manufacturing, marketing and distribution of communication, specialty and packaging papers, as well as softwood, fluff and hardwood market pulp.

**Personal Care Segment** consists of the manufacturing, marketing and distribution of absorbent hygiene products.

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**NOTE 16. SEGMENT DISCLOSURES (CONTINUED)**

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

| <b>SEGMENT DATA</b>   | <b>For the three months ended</b> |                       |
|---|-----------------------------------|-----------------------|
|   | <b>March 31, 2015</b>             | <b>March 31, 2014</b> |
|   | <b>\$</b>                         | <b>\$</b>             |
| Sales   |                                   |                       |
| Pulp and Paper  | <b>1,146</b>                      | 1,168                 |
| Personal Care   | <b>218</b>                        | 233                   |
| Total for reportable segments   | <b>1,364</b>                      | 1,401                 |
| Intersegment sales - Pulp and Paper   | <b>(16)</b>                       | (7)                   |
| Consolidated sales  | <b>1,348</b>                      | 1,394                 |
| Depreciation and amortization and impairment and write-down of property, plant and equipment              |                                   |                       |
| Pulp and Paper  | <b>74</b>                         | 83                    |
| Personal Care   | <b>16</b>                         | 16                    |
| Total for reportable segments   | <b>90</b>                         | 99                    |
| Impairment and write-down of property, plant and equipment - Pulp and Paper                               | <b>19</b>                         |                       |
| Consolidated depreciation and amortization and impairment and write-down of property, plant and equipment | <b>109</b>                        | 99                    |
| Operating income (loss) <sup>(1)</sup>  |                                   |                       |
| Pulp and Paper  | <b>75</b>                         | 89                    |
| Personal Care   | <b>10</b>                         | 14                    |
| Corporate   | <b>(14)</b>                       | (24)                  |
| Consolidated operating income   | <b>71</b>                         | 79                    |
| Interest expense, net   | <b>26</b>                         | 25                    |
| Earnings before income taxes  | <b>45</b>                         | 54                    |
| Income tax expense  | <b>9</b>                          | 15                    |

- (1) As a result of changes in the Company's organization structure, the Company has changed the way it allocates certain Corporate general and administrative costs to the segments. Further, certain Corporate costs not related to segment activities, as well as the mark-to-market impact on stock-based compensation awards, will be presented on the Corporate line. As a result, the Company has revised its 2014 segment disclosures to conform to its 2015 presentation. (Previously reported numbers for Operating income (loss) are as follows; Pulp and Paper: \$69 million, Personal Care: \$15 million, Corporate \$(5) million).

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**NOTE 17.**

**SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION**

The following information is presented as required under Rule 3-10 of Regulation S-X, in connection with the Company's issuance of debt securities that are fully and unconditionally guaranteed by Domtar Paper Company, LLC, a 100% owned subsidiary of the Company, Domtar Industries LLC (and subsidiaries, excluding Domtar Funding LLC), Ariva Distribution Inc., Domtar Delaware Investments Inc., Domtar Delaware Holdings, LLC, Domtar A.W. LLC (and subsidiary), Domtar AI Inc., Attends Healthcare Products Inc., EAM Corporation, Domtar Personal Care Absorbent Hygiene Inc, and Associated Hygienic Products LLC., all 100% owned subsidiaries of the Company ( "Guarantor Subsidiaries" ), on a joint and several basis. The Guaranteed Debt will not be guaranteed by certain of Domtar's own 100% owned subsidiaries; including Domtar Delaware Holdings Inc. and its foreign subsidiaries, including Attends Healthcare Limited, Domtar Inc. and Laboratorios Indas. S.A.U., (collectively the "Non-Guarantor Subsidiaries" ). The subsidiary's guarantee may be released in certain customary circumstances, such as if the subsidiary is sold or sells all of its assets, if the subsidiary's guarantee of the Credit Agreement is terminated or released and if the requirements for legal defeasance to discharge the indenture have been satisfied.

The following supplemental condensed consolidating financial information sets forth, on an unconsolidated basis, the Balance Sheets at March 31, 2015 and December 31, 2014 and the Statements of Earnings and Comprehensive (Loss) Income and Cash Flows for the three months ended March 31, 2015, and March 31, 2014 for Domtar Corporation (the "Parent" ), and on a combined basis for the Guarantor Subsidiaries and, on a combined basis, the Non-Guarantor Subsidiaries. The supplemental condensed consolidating financial information reflects the investments of the Parent in the Guarantor Subsidiaries, as well as the investments of the Guarantor Subsidiaries in the Non-Guarantor Subsidiaries, using the equity method.

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**NOTE 17. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

| CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND<br>COMPREHENSIVE LOSS | For the three months ended March 31, 2015 |                           |                                   |                              |              |
|---|---|---------------------------|-----------------------------------|------------------------------|--------------|
|   | Parent                                    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated |
|   | \$  | \$                        | \$                                | \$                           | \$           |
| Sales   |   | 1,116                     | 533                               | (301)                        | 1,348        |
| Operating expenses  |   |                           |                                   |                              |              |
| Cost of sales, excluding depreciation and amortization                  |   | 976                       | 387                               | (301)                        | 1,062        |
| Depreciation and amortization   |   | 64                        | 26                                |                              | 90           |
| Selling, general and administrative                                     | 5   | 33                        | 62                                |                              | 100          |
| Impairment and write-down of property, plant and equipment              |   | 19                        |                                   |                              | 19           |
| Closure and restructuring costs   |   |                           | 1                                 |                              | 1            |
| Other operating loss (income), net                                      | 2   | 5                         | (2)                               |                              | 5            |
|   | 7   | 1,097                     | 474                               | (301)                        | 1,277        |
| Operating (loss) income   | (7)                                       | 19                        | 59                                |                              | 71           |
| Interest expense (income), net  | 26  | 7                         | (7)                               |                              | 26           |
| (Loss) earnings before income taxes                                     | (33)                                      | 12                        | 66                                |                              | 45           |
| Income tax (benefit) expense  | (9)                                       | 1                         | 17                                |                              | 9            |
| Share in earnings of equity accounted investees                         | 60  | 49                        |                                   | (109)                        |              |
| Net earnings  | 36  | 60                        | 49                                | (109)                        | 36           |
| Other comprehensive loss  | (178)                                     | (180)                     | (166)                             | 346                          | (178)        |
| Comprehensive loss  | (142)                                     | (120)                     | (117)                             | 237                          | (142)        |

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**NOTE 17. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

| CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND<br>COMPREHENSIVE INCOME | For the three months ended March 31, 2014 |                           |                                   |                              |              |
|---|---|---------------------------|-----------------------------------|------------------------------|--------------|
|   | Parent                                    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated |
|   | \$  | \$                        | \$                                | \$                           | \$           |
| Sales   |   | 1,109                     | 554                               | (269)                        | 1,394        |
| Operating expenses  |   |                           |                                   |                              |              |
| Cost of sales, excluding depreciation and amortization                    |   | 933                       | 439                               | (269)                        | 1,103        |
| Depreciation and amortization   |   | 68                        | 31                                |                              | 99           |
| Selling, general and administrative                                       | 13  | 73                        | 28                                |                              | 114          |
| Closure and restructuring costs   |   | 1                         |                                   |                              | 1            |
| Other operating loss, net   |   | (1)                       | (1)                               |                              | (2)          |
|   | 13  | 1,074                     | 497                               | (269)                        | 1,315        |
| Operating (loss) income   | (13)                                      | 35                        | 57                                |                              | 79           |
| Interest expense (income), net  | 25  | 5                         | (5)                               |                              | 25           |
| (Loss) earnings before income taxes                                       | (38)                                      | 30                        | 62                                |                              | 54           |
| Income tax (benefit) expense  | (10)                                      | 8                         | 17                                |                              | 15           |
| Share in earnings of equity accounted investees                           | 67  | 45                        |                                   | (112)                        |              |
| Net earnings  | 39  | 67                        | 45                                | (112)                        | 39           |
| Other comprehensive income (loss)   | 1   | (1)                       | (35)                              |                              | (35)         |
| Comprehensive income  | 40  | 66                        | 10                                | (112)                        | 4            |

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**NOTE 17. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

| <b><u>CONDENSED CONSOLIDATING BALANCE SHEET</u></b> | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>March 31, 2015<br/>Non-<br/>Guarantor<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated</b> |
|---|---------------|-----------------------------------|---|--------------------------------------|---------------------|
|   | \$            | \$                                | \$  | \$                                   | \$                  |
| <b>Assets</b>                                       |               |                                   |   |                                      |                     |
| <b>Current assets</b>                               |               |                                   |   |                                      |                     |
| Cash and cash equivalents                           | 79            | 20                                | 84  |                                      | 183                 |
| Receivables   |               | 407                               | 253   |                                      | 660                 |
| Inventories   |               | 482                               | 222   |                                      | 704                 |
| Prepaid expenses                                    | 11            | 9                                 | 8   |                                      | 28                  |
| Income and other taxes receivable                   | 49            |                                   | 8   | (45)                                 | 12                  |
| Intercompany accounts                               | 975           | 4,611                             | 15  | (5,601)                              |                     |
| Deferred income taxes                               |               | 49                                | 29  |                                      | 78                  |
| <b>Total current assets</b>                         | <b>1,114</b>  | <b>5,578</b>                      | <b>619</b>  | <b>(5,646)</b>                       | <b>1,665</b>        |
| Property, plant and equipment, at cost              |               | 6,156                             | 2,570   |                                      | 8,726               |
| Accumulated depreciation                            |               | (4,063)                           | (1,668)   |                                      | (5,731)             |
| <b>Net property, plant and equipment</b>            |               | <b>2,093</b>                      | <b>902</b>  |                                      | <b>2,995</b>        |
| Goodwill  |               | 296                               | 241   |                                      | 537                 |
| Intangible assets, net of amortization              |               | 261                               | 351   |                                      | 612                 |
| Investments in affiliates                           | 7,895         | 2,028                             |   | (9,923)                              |                     |
| Intercompany long-term advances                     | 6             | 80                                | 435   | (521)                                |                     |
| Other assets  | 31            | 23                                | 126   | (29)                                 | 151                 |
| <b>Total assets</b>                                 | <b>9,046</b>  | <b>10,359</b>                     | <b>2,674</b>  | <b>(16,119)</b>                      | <b>5,960</b>        |
| <b>Liabilities and shareholders' equity</b>         |               |                                   |   |                                      |                     |
| <b>Current liabilities</b>                          |               |                                   |   |                                      |                     |
| Bank indebtedness                                   |               | 6                                 |   |                                      | 6                   |
| Trade and other payables                            | 70            | 420                               | 207   |                                      | 697                 |
| Intercompany accounts                               | 4,606         | 917                               | 78  | (5,601)                              |                     |
| Income and other taxes payable                      | 28            | 42                                | 14  | (45)                                 | 39                  |
| Long-term debt due within one year                  | 166           | 2                                 | 1   |                                      | 169                 |
| <b>Total current liabilities</b>                    | <b>4,870</b>  | <b>1,387</b>                      | <b>300</b>  | <b>(5,646)</b>                       | <b>911</b>          |
| Long-term debt                                      | 1,168         | 1                                 | 10  |                                      | 1,179               |
| Intercompany long-term loans                        | 273           | 248                               |   | (521)                                |                     |
| Deferred income taxes and other                     | 4             | 648                               | 167   | (29)                                 | 790                 |

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|  |       |        |       |          |       |
|--|-------|--------|-------|----------|-------|
| Other liabilities and deferred credits     | 21    | 180    | 169   |          | 370   |
| Shareholders' equity                       | 2,710 | 7,895  | 2,028 | (9,923)  | 2,710 |
| Total liabilities and shareholders' equity | 9,046 | 10,359 | 2,674 | (16,119) | 5,960 |

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**(UNAUDITED)**

**NOTE 17. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

| CONDENSED CONSOLIDATING BALANCE SHEET       | December 31, 2014 |                                 |   |                                    | Consolidated<br>\$ |
|---|-------------------|---------------------------------|---|------------------------------------|--------------------|
|   | Parent<br>\$      | Guarantor<br>Subsidiaries<br>\$ | Non-<br>Guarantor<br>Subsidiaries<br>\$ | Consolidating<br>Adjustments<br>\$ |                    |
| <b>Assets</b>                               |                   |                                 |   |                                    |                    |
| <b>Current assets</b>                       |                   |                                 |   |                                    |                    |
| Cash and cash equivalents                   | 79                | 18                              | 77                                      |                                    | 174                |
| Receivables                                 |                   | 370                             | 258                                     |                                    | 628                |
| Inventories                                 |                   | 495                             | 219                                     |                                    | 714                |
| Prepaid expenses                            | 11                | 7                               | 7                                       |                                    | 25                 |
| Income and other taxes receivable           | 37                |                                 | 17                                      |                                    | 54                 |
| Intercompany accounts                       | 977               | 4,613                           | 13                                      | (5,603)                            |                    |
| Deferred income taxes                       |                   | 40                              | 35                                      |                                    | 75                 |
| <b>Total current assets</b>                 | <b>1,104</b>      | <b>5,543</b>                    | <b>626</b>                              | <b>(5,603)</b>                     | <b>1,670</b>       |
| Property, plant and equipment, at cost      |                   | 6,119                           | 2,790                                   |                                    | 8,909              |
| Accumulated depreciation                    |                   | (3,985)                         | (1,793)                                 |                                    | (5,778)            |
| <b>Net property, plant and equipment</b>    |                   | <b>2,134</b>                    | <b>997</b>                              |                                    | <b>3,131</b>       |
| Goodwill                                    |                   | 296                             | 271                                     |                                    | 567                |
| Intangible assets, net of amortization      |                   | 263                             | 398                                     |                                    | 661                |
| Investments in affiliates                   | 8,015             | 2,153                           |   | (10,168)                           |                    |
| Intercompany long-term advances             | 6                 | 80                              | 434                                     | (520)                              |                    |
| Other assets                                | 31                | 11                              | 135                                     | (21)                               | 156                |
| <b>Total assets</b>                         | <b>9,156</b>      | <b>10,480</b>                   | <b>2,861</b>                            | <b>(16,312)</b>                    | <b>6,185</b>       |
| <b>Liabilities and shareholders' equity</b> |                   |                                 |   |                                    |                    |
| <b>Current liabilities</b>                  |                   |                                 |   |                                    |                    |
| Bank indebtedness                           |                   | 10                              |   |                                    | 10                 |
| Trade and other payables                    | 69                | 409                             | 243                                     |                                    | 721                |
| Intercompany accounts                       | 4,582             | 925                             | 96                                      | (5,603)                            |                    |
| Income and other taxes payable              | 2                 | 9                               | 15                                      |                                    | 26                 |
| Long-term debt due within one year          | 166               | 2                               | 1                                       |                                    | 169                |
| <b>Total current liabilities</b>            | <b>4,819</b>      | <b>1,355</b>                    | <b>355</b>                              | <b>(5,603)</b>                     | <b>926</b>         |
| Long-term debt                              | 1,168             | 2                               | 11                                      |                                    | 1,181              |
| Intercompany long-term loans                | 260               | 260                             |   | (520)                              |                    |
| Deferred income taxes and other             |                   | 675                             | 156                                     | (21)                               | 810                |

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|  |       |        |       |          |       |
|--|-------|--------|-------|----------|-------|
| Other liabilities and deferred credits     | 19    | 173    | 186   |          | 378   |
| Shareholders' equity                       | 2,890 | 8,015  | 2,153 | (10,168) | 2,890 |
| Total liabilities and shareholders' equity | 9,156 | 10,480 | 2,861 | (16,312) | 6,185 |

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**NOTE 17. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

| CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS   | For the three months ended March 31, 2015 |           |                   |               |              |
|---|---|-----------|-------------------|---------------|--------------|
|   | Parent                                    | Guarantor | Non-<br>Guarantor | Consolidating | Consolidated |
|   | \$  | \$        | \$                | \$            | \$           |
| <b>Operating activities</b>   |   |           |                   |               |              |
| Net earnings  | 36  | 60        | 49                | (109)         | 36           |
| Changes in operating and intercompany assets and liabilities and non-cash items, included in net earnings | (10)                                      | 17        | (25)              | 109           | 91           |
| Cash flows provided from operating activities   | 26  | 77        | 24                |               | 127          |
| <b>Investing activities</b>   |   |           |                   |               |              |
| Additions to property, plant and equipment  |   | (46)      | (24)              |               | (70)         |
| Proceeds from disposals of property, plant and equipment  |   |           | 1                 |               | 1            |
| Cash flows used for investing activities  |   | (46)      | (23)              |               | (69)         |
| <b>Financing activities</b>   |   |           |                   |               |              |
| Dividend payments   | (24)                                      |           |                   |               | (24)         |
| Net change in bank indebtedness   |   | (4)       |                   |               | (4)          |
| Repayment of long-term debt   |   | (1)       |                   |               | (1)          |
| Stock repurchase  | (13)                                      |           |                   |               | (13)         |
| Increase in long-term advances to related parties   |   | (24)      |                   | 24            |              |
| Decrease in long-term advances to related parties   | 10  |           | 14                | (24)          |              |
| Other   | 1   |           |                   |               | 1            |
| Cash flows (used for) provided from financing activities  | (26)                                      | (29)      | 14                |               | (41)         |
| Net increase in cash and cash equivalents   |   | 2         | 15                |               | 17           |
| Impact of foreign exchange on cash  |   |           | (8)               |               | (8)          |
| Cash and cash equivalents at beginning of period  | 79  | 18        | 77                |               | 174          |
| Cash and cash equivalents at end of period  | 79  | 20        | 84                |               | 183          |

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**NOTE 17. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

| CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS   | For the three months ended March 31, 2014 |           |               |               |              |
|---|---|-----------|---------------|---------------|--------------|
|   | Parent                                    | Guarantor | Non-Guarantor | Consolidating | Consolidated |
|   | \$  | \$        | \$            | \$            | \$           |
| <b>Operating activities</b>   |   |           |               |               |              |
| Net earnings  | 39  | 67        | 45            | (112)         | 39           |
| Changes in operating and intercompany assets and liabilities and non-cash items, included in net earnings | 41  | (42)      | (9)           | 112           | 102          |
| Cash flows provided from operating activities   | 80  | 25        | 36            |               | 141          |
| <b>Investing activities</b>   |   |           |               |               |              |
| Additions to property, plant and equipment  |   | (30)      | (15)          |               | (45)         |
| Acquisition of business, net of cash acquired   |   |           | (546)         |               | (546)        |
| Cash flows used for investing activities  |   | (30)      | (561)         |               | (591)        |
| <b>Financing activities</b>   |   |           |               |               |              |
| Dividend payments   | (18)                                      |           |               |               | (18)         |
| Net change in bank indebtedness   | (1)                                       | (7)       |               |               | (8)          |
| Change of revolving bank credit facility  | (80)                                      |           |               |               | (80)         |
| Proceeds from receivables securitization facilities   |   |           | 90            |               | 90           |
| Payments on receivables securitization facilities   |   |           | (58)          |               | (58)         |
| Increase in long-term advances to related parties   | (389)                                     | (6)       |               | 395           |              |
| Decrease in long-term advances to related parties   |   |           | 395           | (395)         |              |
| Other   | 2   |           | (1)           |               | 1            |
| Cash flows (used for) provided from financing activities  | (486)                                     | (13)      | 426           |               | (73)         |
| Net decrease in cash and cash equivalents   | (406)                                     | (18)      | (99)          |               | (523)        |
| Impact of foreign exchange on cash  |   |           | (2)           |               | (2)          |
| Cash and cash equivalents at beginning of period  | 439                                       | 22        | 194           |               | 655          |
| Cash and cash equivalents at end of period  | 33  | 4         | 93            |               | 130          |

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

This Management's Discussion and Analysis ( MD&A ) of Financial Condition and Results of Operations should be read in conjunction with Domtar Corporation's unaudited interim financial statements and notes thereto included in the Quarterly Report. The MD&A should also be read in conjunction with the historical financial information contained in our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission ( SEC ) on February 27, 2015. Throughout this MD&A, unless otherwise specified, Domtar Corporation, the Company, Domtar, we, us and our refers to Domtar Corporation and its subsidiaries. Domtar Corporation's common stock is listed on the New York Stock Exchange and the Toronto Stock Exchange. Except where otherwise indicated, all financial information reflected herein is determined on the basis of accounting principles generally accepted in the United States ( GAAP ).

In accordance with industry practice, in this report, the term ton or the symbol ST refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tons. The term metric ton or the symbol ADMT refers to an air dry metric ton. In this report, unless otherwise indicated, all dollar amounts are expressed in U.S. dollars, and the term dollars and the symbol \$ refer to U.S. dollars. In the following discussion, unless otherwise noted, references to increases or decreases in income and expense items, prices, contribution to net earnings (loss), and shipment volume are based on the three-month periods ended March 31, 2015 and 2014. The three-month periods are also referred to as the first quarter of 2015 and 2014 or Q1 2015 and Q1 2014. Reference to notes refers to footnotes to the consolidated financial statements and notes thereto included in Item 1 of this form 10-Q.

This MD&A of financial condition and results of operations is intended to provide investors with an understanding of our recent performance, financial condition and outlook. Topics discussed and analysed include:

Overview

Q1 2015 Highlights

Consolidated Results of Operations and Segment Review

Outlook

Liquidity and Capital Resources

**OVERVIEW**

Domtar Corporation designs, manufactures, markets and distributes a wide variety of fiber-based products, including communication papers, specialty and packaging papers, and absorbent hygiene products. The foundation of our business is a network of world-class wood fiber-converting assets that produce papergrade, fluff and specialty pulp. We are the largest integrated marketer and manufacturer of uncoated freesheet paper in North America with recognized brands such as Cougar<sup>®</sup>, Lynx<sup>®</sup> Opaque Ultra, Husky<sup>®</sup> Opaque Offset, First Choice<sup>®</sup>, EarthChoice<sup>®</sup> and Xerox<sup>®</sup> Paper and Specialty Media. Domtar is also a marketer and producer of a broad line of absorbent hygiene products marketed primarily under the Attends<sup>®</sup>, IncoPack<sup>®</sup> and Indasec<sup>®</sup> brand names.

We have two reportable segments as described below. Each reportable segment offers different products and services and requires different manufacturing processes, technology and/or marketing strategies. The following summary briefly describes the operations included in each of our reportable segments.

**Pulp and Paper:** Our Pulp and Paper segment consists of the design, manufacturing, marketing and distribution of communication papers and specialty and packaging papers, as well as softwood, fluff and hardwood market pulp.

**Personal Care:** Our Personal Care segment consists of the manufacturing, marketing and distribution of absorbent hygiene products.

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As a result of changes in the Company's organization structure, we have changed the way we allocate certain Corporate general and administrative costs to the segments. Further, certain Corporate costs not related to segment activities, as well as the mark-to-market impact on stock-based compensation awards, will be presented on the Corporate line. As a result, we have revised our 2014 segment disclosures to conform with our 2015 presentation.

**Table of Contents****Q1 2015 HIGHLIGHTS**

Operating income and net earnings decreased by 10% and 8%, respectively from Q1 2014

Sales decreased by 3% from Q1 2014. Net average selling prices for pulp and paper were down from Q1 2014. Volume in paper was down while pulp volume was up from Q1 2014

Recognition of impairment and write-down of property, plant and equipment of \$19 million related to the decision to convert a paper machine at our Ashdown mill to a fluff pulp line

We repurchased \$13 million of our common stock and paid \$24 million in dividends

| FINANCIAL HIGHLIGHTS<br><i>(In millions of dollars, unless otherwise noted)</i> | Three months ended      |                            | Variance |      |
|---|-------------------------|----------------------------|----------|------|
|   | March 31,<br>2015       | March 31,<br>2014          | \$       | %    |
| Sales   | \$ 1,348                | \$ 1,394                   | (\$46)   | -3%  |
| Operating income  | 71                      | 79                         | (8)      | -10% |
| Net earnings  | 36                      | 39                         | (3)      | -8%  |
| Net earnings per common share (in dollars) <sup>1</sup> :                       |                         |                            |          |      |
| Basic   | 0.56                    | 0.60                       | (0.04)   | -7%  |
| Diluted   | 0.56                    | 0.60                       | (0.04)   | -7%  |
|   | At<br>March 31,<br>2015 | At<br>December 31,<br>2014 |          |      |
| Total assets  | \$ 5,960                | \$ 6,185                   |          |      |
| Total long-term debt, including current portion                                 | \$ 1,348                | \$ 1,350                   |          |      |

<sup>1</sup> Refer to Note 5 Earnings Per Common Share of the financial statements in this Quarterly Report on Form 10-Q for more information on the calculation of net earnings per common share.

**Table of Contents****CONSOLIDATED RESULTS OF OPERATIONS AND SEGMENT REVIEW**

This section presents a discussion and analysis of our Q1 2015 net sales, operating income (loss) and other information relevant to the understanding of our results of operations.

**Analysis of Net Sales**

## By Business Segment

|   | Three months ended |                   | Variance |      |
|---|--------------------|-------------------|----------|------|
|   | March 31,<br>2015  | March 31,<br>2014 | \$       | %    |
| Pulp and Paper  | \$ 1,146           | \$ 1,168          | (22)     | -2%  |
| Personal Care   | 218                | 233               | (15)     | -6%  |
| Total for reportable segments                         | 1,364              | 1,401             | (37)     | -3%  |
| Intersegment sales                                    | (16)               | (7)               | (9)      |      |
| Consolidated  | 1,348              | 1,394             | (46)     | -3%  |
| Shipments   |                    |                   |          |      |
| Paper manufactured (in thousands of ST)               | 804                | 804               |          |      |
| Communication Papers                                  | 669                | 678               | (9)      | -1%  |
| Specialty and Packaging                               | 135                | 126               | 9        | 7%   |
| Paper sourced from third parties (in thousands of ST) | 35                 | 50                | (15)     | -30% |
| Paper total (in thousands of ST)                      | 839                | 854               | (15)     | -2%  |
| Pulp (in thousands of ADMT)                           | 350                | 318               | 32       | 10%  |

**Analysis of Changes in Net Sales**

|                    | Q1 2015 vs. Q1 2014          |              |          |       |
|--------------------|------------------------------|--------------|----------|-------|
|                    | % Change in Net Sales due to |              |          |       |
|                    | Net Price                    | Volume / Mix | Currency | Total |
| Pulp and Paper     | -2%                          |              |          | -2%   |
| Personal Care      | -1%                          | 4%           | -9%      | -6%   |
| Consolidated sales | -2%                          | 1%           | -2%      | -3%   |

**Table of Contents****Analysis of Operating Income/(Loss)**

By Business Segment

|                               | Three months ended |                   | Variance |      |
|-------------------------------|--------------------|-------------------|----------|------|
|                               | March 31,<br>2015  | March 31,<br>2014 | \$       | %    |
| Operating income (loss)       |                    |                   |          |      |
| Pulp and Paper                | 75                 | 89                | (14)     | -16% |
| Personal Care                 | 10                 | 14                | (4)      | -29% |
| Corporate                     | (14)               | (24)              | 10       |      |
| Consolidated operating income | 71                 | 79                | (8)      | -10% |

**Q1 2015 vs. Q1 2014**

|                               | \$ Change in Segmented Operating Income due to |           |                            |                                   |                          |  |                                     | Total |
|-------------------------------|--|-----------|----------------------------|-----------------------------------|--------------------------|--|-------------------------------------|-------|
|                               | Volume/Mix                                     | Net Price | Input Costs <sup>(a)</sup> | Operating <sup>(b)</sup> expenses | Currency, net of hedging | Depreciation/impairment <sup>(c)</sup> | Other Income/expense <sup>(d)</sup> |       |
| Pulp and Paper                | 3  | (29)      | 16                         | (11)                              | 26                       | (12)                                   | (7)                                 | (14)  |
| Personal Care                 |  | (2)       | 2                          |                                   | (1)                      | (2)                                    | (1)                                 | (4)   |
| Corporate                     |  |           |                            | 8 <sup>(e)</sup>                  | 1                        |  | 1                                   | 10    |
| Consolidated operating income | 3  | (31)      | 18                         | (3)                               | 26                       | (14)                                   | (7)                                 | (8)   |

(a) Includes raw materials (fiber and chemicals) and energy expenses.

(b) Includes maintenance, freight costs, SG&amp;A expenses and other costs.

(c) In Q1 2015, we recorded \$19 million of accelerated depreciation related to the conversion of a paper machine to a fluff pulp line at Ashdown. In 2014, we did not record any impairment charges. Depreciation charges were lower by \$5 million in Q1 2015, excluding foreign exchange impact.

(d)

Q1 2015 operating expenses / income includes:

- Allowance for doubtful accounts (\$5 million)

Q1 2014 operating expenses / income includes:

- Allowance for doubtful accounts (\$1 million)

- Foreign exchange gain on working capital items (\$3 million)

(e) Lower merger and acquisition costs, decrease in the mark-to-market impact on stock-based compensation and gain on asset disposition.

**Commentary First quarter of 2015 compared to First quarter of 2014****Consolidated Sales**

Sales in Q1 2015 amounted to \$1,348 million, a decrease of \$46 million, or approximately 3%, from sales in Q1 2014. Net prices were down 2% and unfavorable foreign exchange, mostly due to the fluctuation between the U.S. dollar and the Euro, for 2%. Sales were positively impacted by higher sales volume of 1%.

**Consolidated Operating Income** Refer to segment analysis.**Interest Expense, net**

We incurred \$26 million of net interest expense in Q1 2015, an increase of \$1 million compared to net interest expense of \$25 million in Q1 2014.

**Income Taxes**

In Q1 2015, our income tax expense was \$9 million, consisting of a current income tax expense of \$24 million and a deferred income tax benefit of \$15 million. This compares to a tax expense of \$15 million in Q1 2014, consisting of a current income tax expense of \$15 million and no deferred income tax expense. We received income tax refunds, net of payments, of \$23 million during the first quarter of 2015 and the effective tax rate was 20% compared with an effective tax rate of 28% in the first quarter of 2014. The effective tax rate for the first quarter of 2015 was impacted by the impairment and write-down of property, plant, and equipment charges occurring in a high-tax jurisdiction.



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### **Pulp and Paper segment**

Sales in our Pulp and Paper segment decreased by \$22 million, or 2%, when compared to sales in Q1 2014. This decrease in sales is mostly due to a 2% decrease in the net average selling prices, while the decrease in paper sales volume was offset by the increase in pulp sales volume.

Operating income in our Pulp and Paper segment amounted to \$75 million in Q1 2015, a decrease of \$14 million, when compared to operating income of \$89 million in Q1 2014. The comparison was negatively impacted by lower average selling prices, higher accelerated depreciation and higher operating expense partially offset by favorable currency rate and lower input costs, which are mostly related to lower energy due to extreme cold weather in Q1 2014.

### **Personal Care segment**

Sales in our Personal Care segment decreased by \$15 million, or 6%, when compared to sales in Q1 2014. This decrease in sales is mainly due to unfavorable foreign exchange, mostly due to the fluctuation between the U.S. dollar and the Euro, for 9%, and a 1% decrease in net selling prices partially offset by higher sales volume of 4%.

Operating income decreased by 29% or \$4 million in Q1 2015 compared to Q1 2014. The comparison was negatively impacted by lower average net selling prices, higher depreciation and unfavorable foreign exchange between the U.S. dollar and the Euro, partially offset by lower input costs.

## **OUTLOOK**

Our paper shipments are expected to trend with market demand but our paper shipments should benefit from lower import volumes in North America. The second quarter is expected to be affected by seasonally higher maintenance activity in our pulp business and most input costs should return to more normal levels for the remainder of the year. Personal Care results are expected to benefit from market growth, cost savings from the new manufacturing platform and favorable oil-based input costs.

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

For the first quarter of 2015, stock-based compensation expense recognized in our results of operations was \$7 million for all outstanding awards which includes the mark-to-market expense related to the liability awards (\$3 million). This compares to \$8 million, which includes a \$5 million charge of mark-to-market impact in the first quarter of 2014. Compensation costs for performance awards are based on management's best estimate of the final performance measurement.

### **LIQUIDITY AND CAPITAL RESOURCES**

Our principal cash requirements are for ongoing operating costs, pension contributions, working capital and capital expenditures, as well as principal and interest payments on our debt. We expect to fund our liquidity needs primarily with internally generated funds from our operations and, to the extent necessary, through borrowings under our contractually committed credit facility, of which \$600 million is currently undrawn and available, or through our receivables securitization facility, of which \$75 million is currently undrawn and available. Under adverse market conditions, there can be no assurance that these agreements would be available or sufficient. See "Capital Resources" below.

Our ability to make payments on and to refinance our indebtedness, including debt we could incur under the credit and receivable securitization facilities and outstanding Domtar Corporation notes, and for ongoing operating costs including pension contributions, working capital and capital expenditures will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our credit and receivable securitization facilities and debt indentures impose various restrictions and covenants on us that could limit our ability to respond to market conditions, to provide for unanticipated capital investments or to take advantage of business opportunities.

A portion of our cash is held outside the U.S. by foreign subsidiaries. The earnings of the foreign subsidiaries, which reflect full provision for local income taxes, are currently indefinitely reinvested in foreign operations. We do not intend on repatriating those funds and no provision is made for income taxes that would be payable upon the distribution of earnings from foreign subsidiaries as computation of these amounts is not practicable.

### **Operating Activities**

Our operating cash flow requirements are primarily for salaries and benefits, the purchase of fiber, energy and raw materials and other expenses such as property taxes.

Cash flows provided from operating activities totaled \$127 million in Q1 2015, a \$14 million decrease compared to cash flows provided from operating activities of \$141 million in Q1 2014. This decrease in cash flows provided from operating activities is primarily due to lower profitability and an increase in working capital requirements in Q1 2015 when compared to Q1 2014. We received cash of \$34 million in Q1 2014 due to the impact of the Spanish government supplier payment plan on past due receivables and received income tax refunds, net of payments of \$23 million in Q1 2015.

### **Investing Activities**

Cash flows used for investing activities in Q1 2015 amounted to \$69 million, a \$522 million decrease compared to cash flows used for investing activities of \$591 million in the first quarter of 2014.

The use of cash in the first quarter of 2015 was attributable to additions to property, plant and equipment of \$70 million.

The use of cash in the first quarter of 2014 was attributable to the acquisition of Indas of \$546 million ( 399 million) and additions to property, plant and equipment of \$45 million.

Our annual capital expenditures are expected to be approximately between \$310 million and \$330 million.

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### **Financing Activities**

Cash flows used for financing activities totaled \$41 million in the first quarter of 2015 compared to cash flows used for financing activities of \$73 million in the first quarter of 2014.

The use of cash in the first quarter of 2015 was primarily the result of dividend payments (\$24 million), the repurchase of our common stock (\$13 million) and a net repayment of our bank indebtedness (\$4 million). In addition, we repaid \$1 million of capital leases relating to land and buildings in Q1 2015.

The use of cash in the first quarter of 2014 was primarily the result of a net repayment of our revolving bank credit facility and other borrowings (\$48 million), dividend payments (\$18 million) and a net repayment of our bank indebtedness (\$8 million).

### **Capital Resources**

Net indebtedness, consisting of bank indebtedness and long-term debt, net of cash and cash equivalents, was \$1,171 million as of March 31, 2015 compared to \$1,186 million as of December 31, 2014.

#### *Bank Facility*

On October 3, 2014, we entered into a \$600 million amended and restated Credit Agreement, that matures on October 3, 2019. The Credit Agreement provides for a revolving credit facility (including a letter of credit sub-facility and a swingline sub-facility), which may be borrowed in U.S. Dollars, Canadian Dollars (in an amount up to the Canadian Dollar equivalent of \$150 million) and Euros (in an amount up to the Euro equivalent of \$200 million). We may increase the maximum aggregate amount of availability under the Credit Agreement by up to \$400 million, borrow this increased amount as a term loan, and extend the final maturity of the Credit Agreement by one year, subject to the agreement of applicable lenders.

Borrowings under the Credit Agreement bear interest at the LIBOR, EURIBOR or the Canadian bankers' acceptance or prime rates as applicable, plus a margin linked to our credit rating at the time of borrowing. In addition, we pay facility fees quarterly at rates dependent on our credit ratings.

The Credit Agreement contains customary covenants, including two financial covenants: (i) an interest coverage ratio, as defined in the Credit Agreement, that must be maintained at a level of not less than 3 to 1 and (ii) a leverage ratio, as defined in the Credit Agreement that must be maintained at a level of not greater than 3.75 to 1. At March 31, 2015, we were in compliance with our covenants, and no amounts were borrowed (March 31, 2014 - \$80 million). At March 31, 2015, we had no outstanding letters of credit under this credit facility (March 31, 2014 nil). We had \$600 million available under our contractually committed credit facility at March 31, 2015.

#### *Receivables Securitization*

We have a \$150 million receivables securitization facility that matures in March 2016, with a current utilization limit for borrowings or letters of credit of \$121 million at March 31, 2015.

At March 31, 2015, we had no borrowings and \$46 million of letters of credit under the program (March 31, 2014 - \$60 million and \$46 million, respectively). The program contains certain termination events, which include, but are not limited to, matters related to receivable performance, certain defaults occurring under the credit facility or our failure to repay or satisfy material obligations. At March 31, 2015, we had \$75 million available under the accounts receivable securitization facility.

#### *Common Stock*

On February 23, 2015, our Board of Directors approved an increase in the quarterly dividend on our common stock from \$0.375 to \$0.40 per share. This is equivalent to an increase of 7%. The next quarterly dividend of \$0.40 per share is to be paid on July 15, 2015 to shareholders of record on July 2, 2015. The Board of Directors also authorized an increase of \$300 million to our share buyback program. This is in addition to our prior \$1 billion repurchase authorization. As of March 31, 2015, approximately \$369 million remained available.



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### **OFF BALANCE SHEET ARRANGEMENTS**

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

### **GUARANTEES**

#### **Indemnifications**

In the normal course of business, we offer indemnifications relating to the sale of our businesses and real estate. In general, these indemnifications may relate to claims from past business operations, the failure to abide by covenants and the breach of representations and warranties included in sales agreements. Typically, such representations and warranties relate to taxation, environmental, product and employee matters. The terms of these indemnification agreements are generally for an unlimited period of time. At March 31, 2015, we were unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provision has been recorded. These indemnifications have not yielded significant expenses in the past.

#### **Pension Plans**

We have indemnified and held harmless the trustees of our pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions from us or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. At March 31, 2015, we have not recorded a liability associated with these indemnifications, as we do not expect to make any payments pertaining to these indemnifications.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

Refer to Note 2 Recent Accounting Pronouncements, of the financial statements in this Quarterly Report on Form 10-Q.

### **CRITICAL ACCOUNTING ESTIMATES AND POLICIES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates, assumptions and choices amongst acceptable accounting methods that affect our reported results of operations and financial position. Critical accounting estimates pertain to matters that contain a significant level of management estimates about future events, encompass the most complex and subjective judgments and are subject to a fair degree of measurement uncertainty. On an ongoing basis, management reviews its estimates, including those related to environmental matters and asset retirement obligations, impairment of property, plant and equipment and definite-lived intangible assets, useful lives, closure and restructuring costs, impairment of goodwill, impairment of indefinite-lived assets, pension and other post-retirement benefit plans, income taxes, and business combinations. These critical accounting estimates and policies have been reviewed with the Audit Committee of our Board of Directors. We believe these accounting policies, and others, should be reviewed as they are essential to understanding our results of operations and financial condition. Actual results could differ from those estimates.

There has not been any material change to our policies since December 31, 2014. For more details on critical accounting policies, refer to our Annual Report on Form 10-K for the year ended December 31, 2014.

### **FORWARD-LOOKING STATEMENTS**

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

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continued decline in usage of fine paper products in our core North American market;

our ability to implement our business diversification initiatives, including strategic acquisitions;

product selling prices;

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

conditions in the global capital and credit markets, and the economy generally, particularly in the U.S., Canada and Europe;

performance of Domtar Corporation's manufacturing operations, including unexpected maintenance requirements;

the level of competition from domestic and foreign producers;

the effect of, or change in, forestry, land use, environmental and other governmental regulations (including taxation), and accounting regulations;

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

transportation costs;

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

legal proceedings;

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

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

the effect of timing of retirements and changes in the market price of Domtar Corporation's common stock on charges for stock-based compensation;

performance of pension fund investments and related derivatives, if any; and

the other factors described under "Risk Factors", in item 1A of our Annual Report on Form 10-K, for the year ended December 31, 2014.

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

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

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Information relating to quantitative and qualitative disclosure about market risk is contained in our Annual Report on Form 10-K for the year ended December 31, 2014. There has not been any material change in our exposure to market risk since December 31, 2014. A full discussion on Quantitative and Qualitative Disclosure about Market Risk, is found in Note 4 Derivatives and Hedging Activities and Fair Value Measurement, of the financial statements in this Quarterly Report on Form 10-Q.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### *Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities and Exchange Act of 1934, as amended ( Exchange Act ), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As of March 31, 2015, an evaluation was performed by members of management, at the direction and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act). Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2015, our disclosure controls and procedures were effective.

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

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

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

See Note 15 Commitments and Contingencies for the discussion regarding legal proceedings.

There have been no material developments in legal proceedings. For a description of previously reported legal proceedings refer to Part I, Item 3, Legal Proceedings, of our Annual Report on Form 10-K for the year ended December 31, 2014.

**ITEM 1A. RISK FACTORS**

Our Annual Report on Form 10-K for the year ended December 31, 2014, contains important risk factors that could cause our actual results to differ materially from those projected in any forward-looking statement. There were no material changes to the risk factors described in our Annual Report on Form 10-K for the year ended December 31, 2014.

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

Share repurchase activity under our share repurchase program was as follows during the three-month period ended March 31, 2015:

| Period                               | (a) Total number of<br>shares purchased | (b) Average price<br>paid per share | (c) Total number of<br>shares purchased as<br>part of publicly<br>announced<br>Plans or<br>Programs (1) | (d) Approximate<br>dollar value of share<br>that may yet be<br>purchased<br>under<br>the Plans or<br>Programs (in<br>000 s) |
|--------------------------------------|---|-------------------------------------|---|---|
| January 1 through January 31, 2015   | 263,631                                 | 37.93                               | 263,631   | 72,525  |
| February 1 through February 28, 2015 |   |                                     |   | 372,525   |
| March 1 through March 31, 2015       | 77,213                                  | 43.52                               | 77,213  | 369,165   |
|                                      | 340,844                                 | 39.20                               | 340,844   |   |

<sup>(1)</sup> During the first quarter of 2015, we repurchased 340,844 shares at an average price of \$39.20 per share, for a total cost of \$13 million under our stock repurchase program (the Program) approved by the Board of Directors in May 2010 and amended in May 2011, December 2011 and February 2015. We currently have \$369 million of remaining availability under our Program, including an increase of \$300 million approved by the Board of Directors in February 2015. The Program may be suspended, modified or discontinued at any time and we have no obligation to repurchase any amount of our common stock under the Program. The Program has no set expiration date. We repurchase our common stock, from time to time, in part to reduce the dilutive effects of our stock options and awards and to improve shareholders' returns. The timing and amount of stock repurchases will depend on a variety of factors, including the market conditions, availability under the program as well as corporate and regulatory considerations. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

**ITEM 3. DEFAULT UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

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**ITEM 5. OTHER INFORMATION**

Not applicable.

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**ITEM 6. EXHIBITS**

|                 |  |
|-----------------|--|
| Exhibit 12.1    | Computation of Ratio of Earnings to Fixed Charges  |
| Exhibit 31.1    | Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 31.2    | Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.1    | Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 32.2    | Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101.INS | XBRL Instance Document   |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema   |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase   |
| Exhibit 101.DEF | XBRL Taxonomy Extension Definition Linkbase  |
| Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase   |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase  |

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**SIGNATURE**

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

**DOMTAR CORPORATION**

Date: May 8, 2015

By: /s/ DANIEL BURON  
Daniel Buron  
Senior Vice-President and Chief Financial Officer

By: /s/ RAZVAN L. THEODORU  
Razvan L. Theodoru  
Vice-President, Corporate Law and Secretary