

Domtar CORP
Form 10-Q
August 06, 2010
Table of Contents

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 June 30, 2010

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 001-33164

DOMTAR CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State of Incorporation)

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

395 de Maisonneuve West, Montreal, Quebec H3A 1L6 Canada

(Address of principal executive offices) (zip code)

(514) 848-5555

(Registrant's telephone number)

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

Edgar Filing: Domtar CORP - Form 10-Q

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 August 3, 2010, 41,930,966 shares of the issuer's voting common stock were outstanding.

Table of Contents

DOMTAR CORPORATION

FORM 10-Q

For the Quarterly Period Ended June 30, 2010

INDEX

PART I.	<u>FINANCIAL INFORMATION</u>	3
ITEM 1.	<u>FINANCIAL STATEMENTS (UNAUDITED)</u>	3
	<u>CONSOLIDATED STATEMENTS OF EARNINGS</u>	3
	<u>CONSOLIDATED BALANCE SHEETS</u>	4
	<u>CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY</u>	5
	<u>CONSOLIDATED STATEMENTS OF CASH FLOWS</u>	6
	<u>INDEX FOR NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</u>	7
	<u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</u>	8
ITEM 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	39
ITEM 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK</u>	56
ITEM 4.	<u>CONTROLS AND PROCEDURES</u>	58
PART II	<u>OTHER INFORMATION</u>	58
ITEM 1.	<u>LEGAL PROCEEDINGS</u>	58
ITEM 1A.	<u>RISK FACTORS</u>	58
ITEM 2.	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	58
ITEM 3.	<u>DEFAULT UPON SENIOR SECURITIES</u>	58
ITEM 4.	<u>REMOVED AND RESERVED</u>	58
ITEM 5.	<u>OTHER INFORMATION</u>	58
ITEM 6.	<u>EXHIBITS</u>	59

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)****DOMTAR CORPORATION****CONSOLIDATED STATEMENTS OF EARNINGS****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**

CONSOLIDATED STATEMENTS OF EARNINGS	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
	\$	\$	\$	\$
Sales	1,547	1,319	3,004	2,621
Operating expenses				
Cost of sales, excluding depreciation and amortization	1,207	1,116	2,349	2,239
Depreciation and amortization	101	104	203	203
Selling, general and administrative	69	86	153	169
Impairment and write-down of property, plant and equipment (NOTE 8)	14		36	35
Closure and restructuring costs (NOTE 8)	5	6	25	30
Other operating loss (income), net (NOTE 13 and 15)	55	(132)	26	(172)
	1,451	1,180	2,792	2,504
Operating income	96	139	212	117
Interest expense	70	23	102	54
Earnings before income taxes	26	116	110	63
Income tax expense (benefit)	(5)	68	21	60
Net earnings	31	48	89	3
Per common share (in dollars) (NOTE 4)				
Net earnings				
Basic	0.72	1.12	2.07	0.07
Diluted	0.71	1.12	2.05	0.07
Weighted average number of common and exchangeable shares outstanding (millions)				
Basic	43.0	43.0	43.0	43.0
Diluted	43.4	43.0	43.4	43.0

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

Table of Contents

DOMTAR CORPORATION
CONSOLIDATED BALANCE SHEETS

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

	June 30, 2010 (Unaudited) \$	At December 31, 2009 \$
Assets		
Current assets		
Cash and cash equivalents	514	324
Receivables, less allowances of \$8 and \$8	659	536
Inventories (NOTE 6)	616	745
Prepaid expenses	37	46
Income and other taxes receivable	38	414
Deferred income taxes	137	137
Total current assets	2,001	2,202
Property, plant and equipment, at cost	9,269	9,575
Accumulated depreciation	(5,401)	(5,446)
Net property, plant and equipment	3,868	4,129
Intangible assets, net of amortization (NOTE 7)	62	85
Other assets	120	103
Total assets	6,051	6,519
Liabilities and shareholders equity		
Current liabilities		
Bank indebtedness	30	43
Trade and other payables	678	686
Income and other taxes payable	41	31
Long-term debt due within one year (NOTE 10)	30	11
Total current liabilities	779	771
Long-term debt (NOTE 10)	1,186	1,701
Deferred income taxes and other	1,033	1,019
Other liabilities and deferred credits	411	366
Commitments and contingencies (NOTE 12)		
Shareholders equity		
Common stock (NOTE 4)		
\$0.01 par value: authorized 2,000,000,000 shares issued and outstanding: 42,188,548 and 42,062,408 shares		
Exchangeable shares (NOTE 4)		
No par value; unlimited shares authorized; issued and held by nonaffiliates: 923,925 and 982,321 shares		
	73	78
Additional paid-in capital, includes treasury stock of \$29 (NOTE 11)		
\$0.01 par value: 340,130 and nil shares	2,792	2,816

Edgar Filing: Domtar CORP - Form 10-Q

Accumulated deficit	(138)	(216)
Accumulated other comprehensive loss	(85)	(16)
Total shareholders equity	2,642	2,662
Total liabilities and shareholders equity	6,051	6,519

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

Table of Contents

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

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY	Issued and outstanding common and exchangeable stock (millions of shares)	Exchangeable shares	Additional paid-in capital (Unaudited)	Accumulated deficit	Accumulated other comprehensive loss	Total shareholders equity
		\$	\$	\$	\$	\$
Balance at December 31, 2009	43.0	78	2,816	(216)	(16)	2,662
Conversion of exchangeable shares		(5)	5			
Issuance of common shares	0.1					
Stock-based compensation			2			2
Net earnings				89		89
Net derivative losses on cash flow hedges:						
Net loss arising during the period, net of tax of \$3					(11)	(11)
Less: Reclassification adjustments for losses included in net earnings, net of tax of \$(2)					(10)	(10)
Foreign currency translation adjustments					(6)	(6)
Loss on curtailment of post-retirement benefit plan, net of tax of \$(5)					(42)	(42)
Stock repurchase	(0.3)		(29)			(29)
Dividend declared				(11)		(11)
Other			(2)			(2)
Balance at June 30, 2010	42.8	73	2,792	(138)	(85)	2,642

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

Table of Contents

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

CONSOLIDATED STATEMENTS OF CASH FLOWS	Six months ended	
	June 30, 2010 (Unaudited) \$	June 30, 2009 (Unaudited) \$
Operating activities		
Net earnings	89	3
Adjustments to reconcile net earnings to cash flows from operating activities		
Depreciation and amortization	203	203
Deferred income taxes	3	59
Impairment and write-down of property, plant and equipment	36	35
Loss (gain) on repurchase of long-term debt	40	(15)
Net losses on disposals of property, plant and equipment and sale of business	47	
Stock-based compensation expense	2	5
Other	(6)	8
Changes in assets and liabilities, excluding the effects of sale of business		
Receivables	(147)	(117)
Inventories	79	171
Prepaid expenses	(12)	(1)
Trade and other payables	5	(24)
Income and other taxes	392	18
Difference between employer pension and other post-retirement contributions and pension and other post-retirement expense	3	15
Other assets and other liabilities	(1)	3
Cash flows provided from operating activities	733	363
Investing activities		
Additions to property, plant and equipment	(74)	(42)
Proceeds from disposals of property, plant and equipment	14	1
Proceeds from sale of business	97	
Cash flows provided from (used for) investing activities	37	(41)
Financing activities		
Net change in bank indebtedness	(13)	(19)
Change of revolving bank credit facility		90
Issuance of long-term debt		385
Repayment of long-term debt	(530)	(409)
Borrowings under accounts receivable securitization program	20	
Debt issue and tender offer costs	(26)	(13)
Stock repurchase	(19)	
Prepaid on structured stock repurchase	(10)	
Other	(3)	
Cash flows provided from (used for) financing activities	(581)	34
Net increase in cash and cash equivalents	189	356

Edgar Filing: Domtar CORP - Form 10-Q

Translation adjustments related to cash and cash equivalents	1	9
Cash and cash equivalents at beginning of period	324	16
Cash and cash equivalents at end of period	514	381
Supplemental cash flow information		
Net cash payments for:		
Interest	41	64
Income taxes	3	2

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

Table of Contents

INDEX FOR NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1	<u>BASIS OF PRESENTATION</u>	8
NOTE 2	<u>RECENT ACCOUNTING PRONOUNCEMENTS</u>	9
NOTE 3	<u>DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT</u>	10
NOTE 4	<u>EARNINGS PER SHARE</u>	16
NOTE 5	<u>PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS</u>	17
NOTE 6	<u>INVENTORIES</u>	19
NOTE 7	<u>INTANGIBLE ASSETS</u>	20
NOTE 8	<u>CLOSURE AND RESTRUCTURING LIABILITY</u>	21
NOTE 9	<u>CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)</u>	23
NOTE 10	<u>LONG-TERM DEBT</u>	24
NOTE 11	<u>SHAREHOLDERS EQUITY</u>	25
NOTE 12	<u>COMMITMENTS AND CONTINGENCIES</u>	26
NOTE 13	<u>SEGMENT DISCLOSURES</u>	29
NOTE 14	<u>CONDENSED CONSOLIDATING FINANCIAL INFORMATION</u>	31
NOTE 15	<u>SALE OF WOOD BUSINESS</u>	38

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, in the opinion of Management, include all adjustments that are necessary for the fair statement of Domtar Corporation's (the Company) financial position, results of operations, and cash flows for the interim periods presented. Except as disclosed in the Notes to Consolidated Financial Statements, such adjustments are of a normal, recurring nature. Results for the first six 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, 2009, as filed with the Securities and Exchange Commission. The December 31, 2009 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.

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

ACCOUNTING CHANGES IMPLEMENTED

TRANSFERS OF FINANCIAL ASSETS

In June 2009, the Financial Accounting Standards Board (FASB) issued Accounting for Transfers of Financial Assets, which amends the derecognition guidance required by the Transfers and Servicing Topic of FASB Accounting Standards Codification (ASC). Some of the major changes undertaken by this amendment include:

Eliminating the concept of a Qualified Special Purpose Entity (QSPE).

Modifying the derecognition provisions as required by the Transfers and Servicing Topic of FASB ASC:

- o require that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis,
- o clarify when a transferred asset is considered legally isolated from the transferor,
- o modify the requirements related to a transferee s ability to freely pledge or exchange transferred financial assets, and
- o provide guidance on when a portion of a financial asset can be derecognized, thereby restricting the circumstances when sale accounting can be achieved to the following cases:

transfers of individual or groups of financial assets in their entirety and

transfers of participating interests.

The new amendment is effective for financial asset transfers occurring after the beginning of an entity s first fiscal year that begins after November 15, 2009. The Company adopted the new requirements on January 1, 2010. The adoption of the new guidance resulted in an increase in Subordinated interest in securitized receivables of \$20 million presented in Receivables and a corresponding increase in Long-term debt due within one year in the Consolidated Balance Sheet.

VARIABLE INTEREST ENTITIES

In June and December 2009, the FASB issued guidance which requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. This guidance is effective for fiscal years beginning after November 15, 2009, and for interim and annual reporting periods thereafter. The Company adopted the new requirements on January 1, 2010 with no significant impact as the Company has no interests in variable interest entities.

FUTURE ACCOUNTING CHANGES

STOCK COMPENSATION

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

This update is effective for fiscal years and interim periods beginning on or after December 15, 2010 with early adoption permitted. The adoption of this update will have no impact on the Company's consolidated financial statements.

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT

INTEREST RATE RISK

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

CREDIT RISK

The Company is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, the Company reviews new customers' credit history before granting credit and conducts regular reviews of existing customers' credit performance. As at June 30, 2010, the Company did not have any customers that represented more than 10% of the receivables (as at December 31, 2009 the Company did not have any customers that represented more than 10%).

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

COST RISK

Cash flow hedges:

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

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

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

The following table presents the volumes under derivative financial instruments for natural gas contracts outstanding as of June 30, 2010 to hedge forecasted purchases:

Commodity	Notional contractual quantity under derivative contracts		Notional contractual value under derivative contracts (in millions of dollars)	Percentage of forecasted purchases under derivative contracts for			
				2010	2011	2012	2013
Natural gas	6,555,000	MMBTU ⁽¹⁾	\$ 46	29%	21%	7%	1%

(1) MMBTU: Millions of British thermal units

The natural gas derivative contracts were fully effective for accounting purposes as of June 30, 2010. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the three and six months ended June 30, 2010 resulting from hedge ineffectiveness (three and six months ended June 30, 2009 – nil).

FOREIGN CURRENCY RISK

Cash flow hedges:

The Company has manufacturing operations in the United States and Canada. As a result, it is exposed to movements in the foreign currency exchange rate in Canada. Also, certain assets and liabilities are denominated in Canadian dollars and are exposed to foreign currency movements. As a result, the Company's earnings are affected by increases or decreases in the value of the Canadian dollar relative to the U.S. dollar. The Company's risk management policy allows it to hedge a significant portion of its exposure to fluctuations in foreign currency exchange rates for periods up to three years. The Company may use derivative instruments (currency options and foreign exchange forward contracts) to mitigate its exposure to fluctuations in foreign currency exchange rates. Foreign exchange forward contracts are contracts whereby the Company has the obligation to buy Canadian dollars at a specific rate. Currency options purchased are contracts whereby the Company has the right, but not the obligation, to buy Canadian dollars at the strike rate if the Canadian dollar trades above that rate. Currency options sold are contracts whereby the Company has the obligation to buy Canadian dollars at the strike rate if the Canadian dollar trades below that rate.

The Company formally documents the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking the hedge transactions. Foreign exchange forward contracts and currency options contracts used to hedge forecasted purchases in Canadian dollars are designated as cash flow hedges. Current contracts are used to hedge a portion of the forecasted purchases over the next 12 months. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded as a component of Accumulated other comprehensive loss within Shareholders' equity, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

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

The following table presents the currency values under contracts pursuant to currency options outstanding as of June 30, 2010 to hedge forecasted purchases:

Contract		Notional contractual value	Percentage of CDN denominated forecasted expenses, net of revenues under contracts for	
			2010	2011
Currency options purchased	CDN	\$ 360	55%	18%
Currency options sold	CDN	\$ 360	55%	18%

The currency options are fully effective as at June 30, 2010. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the three and six months ended June 30, 2010 resulting from hedge ineffectiveness (three and six months ended June 30, 2009 - nil).

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

Derivatives Designated as Cash Flow Hedging Instruments under the Derivatives and Hedging Topic of FASB ASC	Gain (Loss) Recognized in Accumulated Other Comprehensive Loss on Derivatives (Effective Portion) Three months ended		Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Loss) (Effective Portion) Three months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
	\$	\$	\$	\$
Natural gas swap contracts (a)			(3)	(1)
Oil swap contracts (a)		1		
Currency options (a)	(10)	34	4	(9)
Total	(10)	35	1	(10)

Edgar Filing: Domtar CORP - Form 10-Q

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

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**The Effect of Derivative Instruments on the Consolidated Statements of Earnings and Consolidated Statement of Shareholders Equity**

Derivatives Designated as Cash Flow Hedging Instruments under the Derivatives and Hedging Topic of FASB ASC	Gain (Loss) Recognized in Accumulated Other Comprehensive Loss on Derivatives (Effective Portion) Six months ended		Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss into Income (Loss) (Effective Portion) Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
	\$	\$	\$	\$
Natural gas swap contracts (a)	(5)	(2)	(4)	(1)
Oil swap contracts (a)		1		
Currency options (a)	(6)	21	14	(27)
Total	(11)	20	10	(28)

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

The gain (loss) recorded in Accumulated other comprehensive loss relating to natural gas contracts will be recognized in Cost of sales upon maturity of the derivatives over the next three years at the then prevailing values, which may be different from those at June 30, 2010.

The gain (loss) recorded in Accumulated other comprehensive loss relating to currency options will be recognized in Cost of sales upon maturity of the derivatives over the next 12 months at the then prevailing values, which may be different from those at June 30, 2010.

Fair Value Measurements and Disclosures Topic of FASB ASC 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. Fair Value Measurements and Disclosures Topic of FASB ASC establishes and prioritizes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Edgar Filing: Domtar CORP - Form 10-Q

Level 2 Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

The following tables present information about the Company's financial assets and financial liabilities measured at fair value on a recurring basis for the periods ended June 30, 2010 and December 31, 2009, in accordance with Fair Value Measurements and Disclosures Topic of FASB ASC and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**Fair Value of financial instruments at:**

Derivatives designated as cash flow hedging instruments under the Derivatives and Hedging Topic of FASB ASC:	June 30, 2010 \$	Quoted prices in active markets for identical assets (Level 1) \$	Significant observable inputs (Level 2) \$	Significant unobservable inputs (Level 3) \$	Balance sheet classification
Asset derivatives					
Currency options	7		7		(a) Prepaid expenses
Total Assets	7		7		
Liabilities derivatives					
Currency options	6		6		(a) Trade and other payables
Natural gas swap contracts	10		10		(a) Trade and other payables
Natural gas swap contracts	2		2		(a) Other liabilities and deferred credits
Total Liabilities	18		18		
Other Instruments:					
Long-term debt	1,334	1,334			(b) Long-term debt

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 3. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**Fair Value of financial instruments at:**

Derivatives designated as cash flow hedging instruments under the Derivatives and Hedging Topic of FASB ASC:	December 31, 2009 \$	Quoted prices in active markets for identical assets (Level 1) \$	Significant observable inputs (Level 2) \$	Significant unobservable inputs (Level 3) \$	Balance sheet classification
Asset derivatives					
Currency options	25		25		(a) Prepaid expenses
Total Assets	25		25		
Liabilities derivatives					
Currency options	3		3		(a) Trade and other payables
Natural gas swap contracts	9		9		(a) Trade and other payables
Natural gas swap contracts	2		2		(a) Other liabilities and deferred credits
Total Liabilities	14		14		
Other Instruments:					
Long-term debt	1,805	1,805			(b) Long-term debt

- (a) Fair value of the Company's derivatives is classified under Level 2 (inputs that are observable; directly or indirectly) as it is measured as follows:

For currency options: Fair value is measured using techniques derived from the Black-Scholes pricing model. Interest rates, forward market rates and volatility are used as inputs for such valuation techniques.

For natural gas contracts: Fair value is measured using the discounted difference between contractual rates and quoted market future rates.

Edgar Filing: Domtar CORP - Form 10-Q

- (b) Fair value of the Company's long-term debt is measured by comparison to market prices of our debt. In accordance with the accounting standards, the Company's long-term debt is not carried at fair value on the Consolidated Balance Sheets at June 30, 2010 and December 31, 2009. However, fair value disclosure is required.

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

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 4. EARNINGS PER SHARE

The calculation of earnings (loss) per common share for the three and six months ended June 30, 2010 and June 30, 2009 is based on the weighted average number of Domtar common stock outstanding during the period. The calculation for diluted earnings per common share recognizes the effect of all potential dilutive common stock. A portion of the stock options to purchase common shares is excluded in the computation of diluted net earnings (loss) per share in periods of loss because to do so would have been anti-dilutive.

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

	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Net earnings	\$ 31	\$ 48	\$ 89	\$ 3
Weighted average number of common and exchangeable shares outstanding (millions)	43.0	43.0	43.0	43.0
Effect of dilutive securities (millions)	0.4		0.4	
Weighted average number of diluted common and exchangeable shares outstanding (millions)	43.4	43.0	43.4	43.0
Basic net earnings per share (in dollars)	\$ 0.72	\$ 1.12	\$ 2.07	\$ 0.07
Diluted net earnings per share (in dollars)	\$ 0.71	\$ 1.12	\$ 2.05	\$ 0.07

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

	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Restricted stock units		113,452	26,835	113,452
Options	414,866	669,334	414,866	669,334
Performance-based awards		15,849		15,849

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 5. PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS**DEFINED CONTRIBUTION PLANS**

The Company has several defined contribution plans and multi-employer plans. The pension expense under these plans is equal to the Company's contribution. For the three and six months ended June 30, 2010, the related pension expense was \$6 million and \$15 million, respectively (2009 \$6 million and \$12 million, respectively).

DEFINED BENEFIT PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS

The Company has several defined benefit pension plans covering substantially all employees. Non-unionized employees in Canada joining the Company after June 1, 2000 participate in defined contribution plans. The defined benefit plans are generally contributory in Canada and non-contributory in the United States. The Company also provides other post-retirement plans to eligible Canadian and U.S. employees; the plans are unfunded and include life insurance programs, medical and dental benefits and short-term and long-term disability programs.

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

	Three months ended June 30, 2010		Six months ended June 30, 2010	
	Pension plans \$	Other post-retirement benefit plans \$	Pension plans \$	Other post-retirement benefit plans \$
Service cost	8		17	2
Interest expense	22	1	44	3
Expected return on plan assets	(23)		(46)	
Amortization of net actuarial loss	2		3	
Curtailed loss (gain) (a)	10	(13)	10	(13)
Settlement loss (b)	16		16	
Amortization of prior year service costs			1	
Net periodic benefit cost	35	(12)	45	(8)

(a) The curtailment loss (gain) of \$10 million in the pension plans and \$(3) million in the other post-retirement benefit plans, for the three and six months ended June 30, 2010, is related to the sale of the Wood Business.

A curtailment gain of \$10 million in the other post-retirement benefit plans, for the three and six months ended June 30, 2010, is related to the harmonization of certain of the Company's post-retirement benefit plans.

- (b) The settlement loss of \$16 million in the pension plans for the three and six months ended June 30, 2010, is related to the sale of the Wood Business.

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 5. PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS (CONTINUED)

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

	Three months ended June 30, 2009		Six months ended June 30, 2009	
	Pension plans \$	Other post-retirement benefit plans \$	Pension plans \$	Other post-retirement benefit plans \$
Service cost	9		17	1
Interest expense	19	2	39	4
Expected return on plan assets	(17)		(35)	
Amortization of net actuarial loss			1	
Settlement loss			2	
Curtailment loss			2	
Amortization of prior year service costs	1		2	
Special termination benefits			1	
Net periodic benefit cost	12	2	29	5

The Company contributed \$14 million and \$18 million for the three and six months ended June 30, 2010, respectively (2009 \$10 million and \$16 million, respectively), to the pension plans. The Company also contributed \$3 million for the three and six months ended June 30, 2010, respectively (2009 \$2 million and \$3 million, respectively), to the other post-retirement benefit plans.

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 6. INVENTORIES

The following table presents the components of inventories:

	June 30, 2010	December 31, 2009
	\$	\$
Work in process and finished goods	334	430
Raw materials	96	114
Operating and maintenance supplies	186	201
	616	745

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 7. INTANGIBLE ASSETS

The following table presents the components of intangible assets:

	Weighted average useful lives	June 30, 2010 \$	December 31, 2009 \$
Intangible assets subject to amortization			
Water rights	40	14	15
Power purchase agreements	25	31	31
Customer relationships	20	11	11
Trade names	7	7	7
Supplier agreements	5	6	6
Cutting rights	Units of production method	5	23
		74	93
Accumulated amortization		(12)	(8)
Total intangible assets		62	85

Amortization expense related to intangible assets for the three and six months ended June 30, 2010 was \$1 million and \$2 million, respectively (2009 \$3 million and \$5 million, respectively).

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

	2010 \$	2011 \$	2012 \$	2013 \$	2014 \$
Amortization expense related to intangible assets	4	4	4	3	3

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 8. CLOSURE AND RESTRUCTURING LIABILITY

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

For the three and six months ended June 30, 2010, the Company recorded \$13 million and \$26 million, respectively, of accelerated depreciation and nil and \$1 million, respectively, of severance and termination costs related to the reconfiguration of the Plymouth, North Carolina mill, announced on October 20, 2009.

During the second quarter of 2010, the Company decided to close the Cerritos, California forms converting plant, and recorded a \$1 million write-down for the related assets and \$1 million in severance and termination costs. Operations ceased on July 16, 2010.

On March 16, 2010, the Company announced that it would permanently close its coated groundwood paper mill in Columbus, Mississippi. This measure resulted in the permanent curtailment of 238,000 tons of coated groundwood and 70,000 metric tons of thermo-mechanical pulp, as well as affected 219 employees. The Company recorded a \$9 million write-down for the related fixed assets. In addition, for the three and six months ended June 30, 2010, the Company recorded nil and \$8 million, respectively, of severance and termination costs, \$1 million and \$8 million, respectively, of inventory obsolescence and \$1 million and \$2 million, respectively, of other costs. Operations ceased in April 2010.

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

	Three months ended		Three months ended June 30, 2009			
	June 30, 2010		Papers	Wood	Merchants	Total
	Papers	Total				
	\$	\$	\$	\$	\$	\$
Severance and termination costs	2	2	3	1	1	5
Inventory obsolescence (1)	1	1				
Other	2	2	1			1
Closure and restructuring costs	5	5	4	1	1	6

	Six months ended		Six months ended June 30, 2009			
	June 30, 2010		Papers	Wood	Merchants	Total
	Papers	Total				
	\$	\$	\$	\$	\$	\$
Severance and termination costs	11	11	17	3	1	21
Inventory obsolescence (1)	8	8				
Other	6	6	9			9
Closure and restructuring costs	25	25	26	3	1	30

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

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 8. CLOSURE AND RESTRUCTURING LIABILITY (CONTINUED)

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

	June 30, 2010	December 31, 2009
	\$	\$
Balance at beginning of period	41	47
Additions	11	29
Severance payments	(15)	(32)
Change of estimates		(8)
Effect of foreign currency exchange rate change		5
Sale of Wood Business	(3)	
Balance at end of period	34	41

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 9. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three months ended		Six months ended	
	June 30, 2010 \$	June 30, 2009 \$	June 30, 2010 \$	June 30, 2009 \$
COMPREHENSIVE INCOME (LOSS)				
Net earnings	31	48	89	3
Other comprehensive income (loss)				
Net derivative gains (losses) on cash flow hedges:				
Net gain (loss) arising during the period, net of tax of nil and \$3, respectively (2009 \$ (1) and \$1, respectively)	(10)	35	(11)	20
Less: Reclassification adjustment for gains (losses) included in net earnings, net of tax of \$(1) and \$(2), respectively (2009 nil and \$(1), respectively)	(1)	9	(10)	27
Foreign currency translation adjustments	(45)	98	(6)	66
Loss on curtailment of post-retirement benefit plan, net of tax of \$(5) (2009 nil)	(42)		(42)	
Comprehensive income (loss)	(67)	190	20	116

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 10. LONG-TERM DEBT

	Maturity	Nominal Amount at June 30, 2010 \$	Currency	June 30, 2010 \$	December 31, 2009 \$
Unsecured notes					
7.875% Notes	2011	135	US	138	138
5.375% Notes	2013	74	US	70	293
7.125% Notes	2015	213	US	212	399
9.5% Notes	2016	125	US	136	137
10.75% Notes	2017	400	US	387	386
Secured term loan facility	2014		US	232	336
Capital lease obligations	2010 2028			21	23
Borrowings under accounts receivable securitization program				20	
				1,216	1,712
Less: Due within one year				30	11
				1,186	1,701

UNSECURED NOTES

As a result of a cash tender offer during the second quarter of 2010, the Company repurchased \$238 million of the 5.375% Notes due 2013 and \$187 million of the 7.125% Notes due 2015. The Company recorded a charge of \$40 million related to the repurchase of the notes.

In the first quarter of 2010, the Company made a voluntary repayment of \$100 million on the secured term loan.

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 11. SHAREHOLDERS' EQUITY

During the second quarter of 2010, the Company declared a cash dividend of \$0.25 per share to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc., a subsidiary of Domtar Corporation, payable in July 2010 to shareholders of record as of June 15, 2010.

On August 4, 2010, the Company's Board of Directors approved the second quarterly dividend of \$0.25 per share to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc. This dividend is to be paid on October 15, 2010 to shareholders of record on September 15, 2010.

STOCK REPURCHASE PROGRAM

On May 4, 2010, the Company's Board of Directors authorized a stock repurchase program of up to \$150 million of Domtar Corporation's common stock. Under the stock repurchase 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 stock repurchase 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 stock repurchase program has no set expiration date. The Company repurchases its common stock, from time to time, in part to reduce the dilutive effects of its stock options, awards, and employee stock purchase plan and to improve stockholders' returns.

The Company made open market purchases of its common stock using general corporate funds. Additionally, the Company entered into a structured stock repurchase arrangement with a large financial institution using general corporate funds in order to lower the average cost to acquire shares. The agreement includes terms that require the Company to make an up-front payment of \$10 million to the counterparty financial institution and will result in the receipt of either stock or cash at the maturity of the agreement in the third quarter of 2010, depending on market conditions.

During the second quarter of 2010, the Company repurchased 340,130 shares of common stock at an average price of \$55.79 for a cash cost totalling \$19 million. All shares repurchased are recorded as treasury stock as a component of Additional paid-in capital on the Consolidated Balance Sheet and accounted for under the par value method at \$0.01 per share.

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 12. COMMITMENTS AND CONTINGENCIES**ENVIRONMENT**

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

During the first quarter of 2006, the pulp and paper mill in Prince Albert, Saskatchewan was closed due to poor market conditions. The Company's management determined that the Prince Albert facility was no longer a strategic fit for the Company and will not be reopened. The Province of Saskatchewan may require active decommissioning and reclamation at the Prince Albert facility. In the event decommissioning and reclamation is required at the facility, the work is likely to include investigation and remedial action for areas of significant environmental impacts. The Company has a reserve for the estimated environmental remediation of the site.

An action was commenced by Seaspan International Ltd. (Seaspan) in the Supreme Court of British Columbia, on March 31, 1999 against Domtar Inc. and others with respect to alleged contamination of Seaspan's site bordering Burrard Inlet in North Vancouver, British Columbia, including contamination of sediments in Burrard Inlet, due to the presence of creosote and heavy metals. On February 16, 2010, the government of British Columbia issued a Remediation Order to Seaspan and Domtar in order to define and implement an action plan to address soil, sediment and groundwater issues. This Order was appealed to the Environmental Appeal Board (Board) on March 17, 2010, but there is no suspension in the execution of this Order unless the Board orders otherwise. The hearing is scheduled for January 2011. The authorities are reviewing several remediation plans and a decision is expected in the second half of 2010. The Company has recorded an environmental reserve to address estimated exposure.

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

	June 30, 2010	December 31, 2009
	\$	\$
Balance at beginning of period	111	99
Additions	1	11
Revisions in estimated cash flows		(7)
Environmental spending	(3)	(5)
Accretion	2	3
Impact of sale of Wood Business	(3)	
Effect of foreign currency exchange rate change	(1)	10
Balance at end of period	107	111

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 12. COMMITMENTS AND CONTINGENCIES (CONTINUED)

At June 30, 2010, the Company had a provision of \$107 million for environmental matters and other asset retirement obligations (December 31, 2009 \$111 million). Additional costs, not known or identifiable, could be incurred for remediation efforts. Based on policies and procedures in place to monitor environmental exposure, management believes that such additional remediation costs would not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Climate change regulation

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

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

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

Industrial Boiler Maximum Achievable Controlled Technology Standard (MACT)

The EPA has proposed several standards related to emissions from boilers and process heaters included in the Company's manufacturing process, generally referred to as Boiler MACT. Comments on the proposed standard are expected by August 23, 2010, with the standard to be finalized by December 2010.

It is apparent that, even with the changes suggested by industry, owners and operators will be required to address multiple industrial boilers and process heaters in order to comply with the final rule. The present proposal would set a three-year compliance deadline for existing affected sources, which is also viewed by the industry as challenging. It is not possible, at this time, to provide a complete cost of compliance, but it may have a significant impact on the Company's results of operations, financial positions or cash flows.

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 12. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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 June 30, 2010, cannot be predicted with certainty, it is management's opinion that their resolution will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

The pulp and paper mill in Prince Albert was closed in the first quarter of 2006 and has not been operated since. In December 2009, the Company decided to dismantle the Prince Albert facility. In a grievance relating to the closure of the Prince Albert facility, the union is claiming that it is entitled to the accumulated pension benefits during the actual layoff period because, according to the union, a majority of employees still had recall rights during the layoff. Arbitration in this matter was held in February 2010, and the parties are awaiting the arbitrator's decision. The Company cannot be certain that it will not incur a liability, which could range from \$0 to \$25 million, with respect to this grievance.

On July 31, 1998, Domtar Inc. (now a 100% owned subsidiary of Domtar Corporation) acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement includes a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of Domtar Inc. in specified circumstances, Domtar Inc. may be required to pay an increase in consideration of up to a maximum of \$113 million (CDN\$120 million), an amount gradually declining over a 25-year period. At March 7, 2007, the maximum amount of the purchase price adjustment was approximately \$104 million (CDN\$110 million). No provision was recorded for this potential purchase price adjustment.

On March 14, 2007, the Company received a letter from George Weston Limited (the previous owner of E.B. Eddy and a party to the purchase agreement) demanding payment of \$104 million (CDN\$110 million) as a result of the consummation of the March 2007 combination of the Weyerhaeuser Fine Paper Business with Domtar Inc. (the Transaction). On June 12, 2007, an action was commenced by George Weston Limited against Domtar Inc. in the Superior Court of Justice of the Province of Ontario, Canada, claiming that the consummation of the Transaction triggered the purchase price adjustment and sought a purchase price adjustment of \$104 million (CDN\$110 million) as well as additional compensatory damages. The Company does not believe that the consummation of the Transaction triggers an obligation to pay an increase in consideration under the purchase price adjustment and intends to defend itself vigorously against any claims with respect thereto. However, the Company may not be successful in the defense of such claims, and if the Company is ultimately required to pay an increase in consideration, such payment may have a material adverse effect on the Company's financial position, results of operations or cash flows.

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 June 30, 2010, 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.

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 13. SEGMENT DISCLOSURES

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

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

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

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

The majority of the Company's Wood segment was sold on June 30, 2010 as described in Note 15 Sale of Wood Business .

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

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 13. SEGMENT DISCLOSURES (CONTINUED)

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

SEGMENT DATA	Three months ended June 30, 2010 \$	June 30, 2009 \$	Six months ended June 30, 2010 \$	June 30, 2009 \$
Sales				
Papers	1,317	1,127	2,562	2,233
Paper Merchants	213	205	425	422
Wood	83	46	150	89
Total for reportable segments	1,613	1,378	3,137	2,744
Intersegment sales Papers	(60)	(55)	(122)	(115)
Intersegment sales Wood	(6)	(4)	(11)	(8)
Consolidated sales	1,547	1,319	3,004	2,621
Depreciation and amortization and impairment and write-down of property, plant and equipment				
Papers	95	98	191	192
Paper Merchants	1	1	2	2
Wood	5	5	10	9
Total for reportable segments	101	104	203	203
Impairment and write-down of property, plant and equipment Papers	14		36	35
Consolidated depreciation and amortization and impairment and write-down of property, plant and equipment	115	104	239	238
Operating income (loss)				
Papers ^(a)	149	150	269	144
Paper Merchants	(1)	1		3
Wood	(49)	(12)	(54)	(30)
Corporate	(3)		(3)	
Consolidated operating income	96	139	212	117
Interest expense	70	23	102	54

Edgar Filing: Domtar CORP - Form 10-Q

Earnings before income taxes	26	116	110	63
Income tax expense (benefit)	(5)	68	21	60
Net earnings	31	48	89	3

- (a) The U.S. Internal Revenue Code of 1986, as amended (the Code) permits a refundable excise tax credit for the production and use of alternative bio fuel mixtures derived from biomass. The Company submitted an application with the U.S. Internal Revenue Service (IRS) to be registered as an alternative fuel mixer and received notification that its registration had been accepted in March 2009. The Company began producing and consuming alternative fuel mixtures in February 2009 at its eligible mills. The Company recorded nil and \$25 million, and \$131 and \$177 million, in tax credits for the three and six months ended June 30, 2010 and June 30, 2009, respectively, as a component of Other operating loss (income), net. The \$25 million recorded in the three months ended March 31, 2010 represented an adjustment to amounts presented as deferred revenue at December 31, 2009. The \$25 million was released to income following guidance issued by the U.S. Internal Revenue Service in March 2010. The Company recorded nil and \$7 million, and \$52 and \$70 million in income tax expense related to the alternative fuel mixture income for the three and six months ended June 30, 2010 and June 30, 2009, respectively.

Table of Contents**DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****JUNE 30, 2010****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

The following information is presented as required under Rule 3-10 of Regulation S-X, in connection with the Company's issuance of debt securities that are fully and unconditionally guaranteed by Domtar Paper Company, LLC, a 100% owned subsidiary of the Company and the successor to the Weyerhaeuser Fine Paper Business U.S. Operations, Domtar Industries Inc. (and subsidiaries, excluding Domtar Funding LLC), Ris Paper Company, Inc., Domtar A.W. LLC (and subsidiary) and Domtar Maine LLC (and subsidiary) all 100% owned subsidiaries of the Company (Guarantor Subsidiaries), on a joint and several basis. The Guaranteed Debt will not be guaranteed by certain of Domtar Paper Company, LLC's own 100% owned subsidiaries; including Domtar Delaware Investments Inc., Domtar Delaware Holdings Inc., Domtar Delaware Holdings, LLC, Domtar Inc. and Domtar Pulp and Paper Products Inc. (collectively the Non-Guarantor Subsidiaries).

The following supplemental condensed consolidating financial information sets forth, on an unconsolidated basis, the Balance Sheets at June 30, 2010 and December 31, 2009 and the Statements of Earnings, and Cash Flows for the three and six months ended June 30, 2010 and June 30, 2009 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.

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS (LOSS)	Three months ended June 30, 2010				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
Sales		1,243	538	(234)	1,547
Operating expenses					
Cost of sales, excluding depreciation and amortization		971	470	(234)	1,207
Depreciation and amortization		72	29		101
Selling, general and administrative	3	48	18		69
Impairment and write-down of property, plant and equipment		14			14
Closure and restructuring costs		4	1		5
Other operating loss, net		12	43		55
	3	1,121	561	(234)	1,451
Operating income (loss)	(3)	122	(23)		96
Interest expense (income)	69	15	(14)		70
Earnings (loss) before income taxes	(72)	107	(9)		26
Income tax expense (benefit)	(15)	22	(12)		(5)
Share in earnings of equity accounted investees	88	3		(91)	
Net earnings (loss)	31	88	3	(91)	31

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS (LOSS)	Six months ended June 30, 2010				
	Parent \$	Guarantor Subsidiaries \$	Non- Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Sales		2,434	1,024	(454)	3,004
Operating expenses					
Cost of sales, excluding depreciation and amortization		1,948	855	(454)	2,349
Depreciation and amortization		145	58		203
Selling, general and administrative	10	103	40		153
Impairment and write-down of property, plant and equipment		36			36
Closure and restructuring costs		21	4		25
Other operating loss (income), net		(12)	38		26
	10	2,241	995	(454)	2,792
Operating income (loss)	(10)	193	29		212
Interest expense (income)	100	30	(28)		102
Earnings (loss) before income taxes	(110)	163	57		110
Income tax expense (benefit)	(26)	41	6		21
Share in earnings of equity accounted investees	173	51		(224)	
Net earnings (loss)	89	173	51	(224)	89

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS (LOSS)	Three months ended June 30, 2009				
	Parent \$	Guarantor Subsidiaries \$	Non- Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Sales		1,102	385	(168)	1,319
Operating expenses					
Cost of sales, excluding depreciation and amortization		895	389	(168)	1,116
Depreciation and amortization		78	26		104
Selling, general and administrative	5	62	19		86
Closure and restructuring costs		2	4		6
Other operating loss (income), net		(138)	6		(132)

Edgar Filing: Domtar CORP - Form 10-Q

	5	899	444	(168)	1,180
Operating income (loss)	(5)	203	(59)		139
Interest expense (income)	22	13	(12)		23
Earnings (loss) before income taxes	(27)	190	(47)		116
Income tax expense (benefit)	(10)	78			68
Share in earnings (loss) of equity accounted investees	65	(47)		(18)	
Net earnings (loss)	48	65	(47)	(18)	48

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)**CONDENSED CONSOLIDATING STATEMENT OF EARNINGS (LOSS)**

	Six months ended June 30, 2009				
	Parent \$	Guarantor Subsidiaries \$	Non-Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Sales		2,209	793	(381)	2,621
Operating expenses					
Cost of sales, excluding depreciation and amortization		1,838	782	(381)	2,239
Depreciation and amortization		154	49		203
Selling, general and administrative	9	128	32		169
Impairment of property, plant and equipment		35			35
Closure and restructuring costs		16	14		30
Other operating loss (income), net		(183)	11		(172)
	9	1,988	888	(381)	2,504
Operating income (loss)	(9)	221	(95)		117
Interest expense (income)	52	25	(23)		54
Earnings (loss) before income taxes	(61)	196	(72)		63
Income tax expense (benefit)	(22)	82			60
Share in earnings (loss) of equity accounted investees	42	(72)		30	
Net earnings (loss)	3	42	(72)	30	3

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)**CONDENSED CONSOLIDATING BALANCE SHEET**

	June 30, 2010				
	Parent \$	Guarantor Subsidiaries \$	Non-Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Assets					
Current assets					
Cash and cash equivalents	341	51	122		514
Receivables		499	160		659
Inventories		412	204		616
Prepaid expenses	14	5	18		37
Income and other taxes receivable	26	61	14	(63)	38
Intercompany accounts	196	2,567	342	(3,105)	
Deferred income taxes	1	136			137
Total current assets	578	3,731	860	(3,168)	2,001
Property, plant and equipment, at cost		5,790	3,479		9,269
Accumulated depreciation		(3,108)	(2,293)		(5,401)
Net property, plant and equipment		2,682	1,186		3,868
Intangible assets, net of amortization		18	44		62
Investments in affiliates	5,863	1,372	23	(7,258)	
Intercompany long-term advances	7	80	600	(687)	
Other assets	22	37	61		120
Total assets	6,470	7,920	2,774	(11,113)	6,051
Liabilities and shareholders equity					
Current liabilities					
Bank indebtedness		22	8		30
Trade and other payables	38	338	302		678
Intercompany accounts	2,566	411	128	(3,105)	
Income and other taxes payable	43	37	24	(63)	41
Long-term debt due within one year	8	2	20		30
Total current liabilities	2,655	810	482	(3,168)	779
Long-term debt	1,164	10	12		1,186
Intercompany long-term loans	80	606	1	(687)	
Deferred income taxes and other		1,015	18		1,033
Other liabilities and deferred credits	2	109	300		411
Shareholders equity	2,569	5,370	1,961	(7,258)	2,642

Edgar Filing: Domtar CORP - Form 10-Q

Total liabilities and shareholders equity	6,470	7,920	2,774	(11,113)	6,051
--	-------	-------	-------	----------	-------

34

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)**CONDENSED CONSOLIDATING BALANCE SHEET**

	December 31, 2009				
	Parent \$	Guarantor Subsidiaries \$	Non-Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Assets					
Current assets					
Cash and cash equivalents	237	83	4		324
Receivables		469	67		536
Inventories		446	299		745
Prepaid expenses	5	8	33		46
Income and other taxes receivable		453	23	(62)	414
Intercompany accounts	205	1,808	179	(2,192)	
Deferred income taxes	1	136			137
Total current assets	448	3,403	605	(2,254)	2,202
Property, plant and equipment, at cost		5,733	3,842		9,575
Accumulated depreciation		(2,932)	(2,514)		(5,446)
Net property, plant and equipment		2,801	1,328		4,129
Intangible assets, net of amortization		4	81		85
Investments in affiliates	5,753	1,321	25	(7,099)	
Intercompany long-term advances	7	80	600	(687)	
Other assets	24	24	55		103
Total assets	6,232	7,633	2,694	(10,040)	6,519
Liabilities and shareholders equity					
Current liabilities					
Bank indebtedness		27	16		43
Trade and other payables	33	393	260		686
Intercompany accounts	1,806	266	120	(2,192)	
Income and other taxes payable	43	31	19	(62)	31
Long-term debt due within one year	8	3			11
Total current liabilities	1,890	720	415	(2,254)	771
Long-term debt	1,678	11	12		1,701
Intercompany long-term loans	80	606	1	(687)	
Deferred income taxes and other		999	20		1,019
Other liabilities and deferred credits		111	255		366
Shareholders equity	2,584	5,186	1,991	(7,099)	2,662

Edgar Filing: Domtar CORP - Form 10-Q

Total liabilities and shareholders equity	6,232	7,633	2,694	(10,040)	6,519
--	-------	-------	-------	----------	-------

35

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**

	Six months ended June 30, 2010				
	Parent \$	Guarantor Subsidiaries \$	Non-Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Operating activities					
Net earnings (loss)	89	173	51	(224)	89
Changes in operating and intercompany assets and liabilities and non cash items, included in net earnings (loss)	616	(147)	(49)	224	644
Cash flows provided from operating activities	705	26	2		733
Investing activities					
Additions to property, plant and equipment		(64)	(10)		(74)
Proceeds from disposals of property, plant and equipment			14		14
Proceeds from sale of business			97		97
Increase in long-term advances to related parties	(15)			15	
Decrease in long-term advances to related parties		13	2	(15)	
Cash flows provided from (used for) investing activities	(15)	(51)	103		37
Financing activities					
Net change in bank indebtedness		(5)	(8)		(13)
Repayment of long-term debt	(528)	(2)			(530)
Borrowings under accounts receivable securitization program			20		20
Debt issue and tender offer costs	(26)				(26)
Stock repurchase	(19)				(19)
Prepaid on structured stock repurchase	(10)				(10)
Other	(3)				(3)
Cash flows provided from (used for) financing activities	(586)	(7)	12		(581)
Net increase (decrease) in cash and cash equivalents	104	(32)	117		189
Translation adjustments related to cash and cash equivalents			1		1
Cash and cash equivalents at beginning of period	237	83	4		324
Cash and cash equivalents at end of period	341	51	122		514

Table of Contents

DOMTAR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2010
(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)
(UNAUDITED)

NOTE 14. CONDENSED CONSOLIDATING FINANCIAL INFORMATION (CONTINUED)**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**

	Six months ended June 30, 2009				
	Parent \$	Guarantor Subsidiaries \$	Non-Guarantor Subsidiaries \$	Consolidating Adjustments \$	Consolidated \$
Operating activities					
Net earnings (loss)	3	42	(72)	30	3
Changes in operating and intercompany assets and liabilities and non cash items, included in net earnings (loss)	650	(341)	81	(30)	360
Cash flows provided from (used for) operating activities	653	(299)	9		363
Investing activities					
Additions to property, plant and equipment		(28)	(14)		(42)
Proceeds from disposals of property, plant and equipment and sale of trademarks			1		1
Increase in long-term advances to related parties	(384)			384	
Decrease in long-term advances to related parties		355	29	(384)	
Cash flows provided from (used for) investing activities	(384)	327	16		(41)
Financing activities					
Net change in bank indebtedness		(8)	(11)		(19)
Repayment of revolving bank credit facility	90				90
Issuance of long-term debt	385				385
Repayment of long-term debt	(406)	(3)			(409)
Debt issue and tender offer costs	(13)				(13)
Cash flows provided from (used for) financing activities	56	(11)	(11)		34
Net increase in cash and cash equivalents	325	17	14		356
Translation adjustments related to cash and cash equivalents			9		9
Cash and cash equivalents at beginning of period		14	2		16
Cash and cash equivalents at end of period	325	31	25		381

Table of Contents

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2010

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 15. SALE OF WOOD BUSINESS

On June 30, 2010, the Company sold its Wood Business to EACOM Timber Corporation (EACOM), following the consents and customary closing conditions, which included approvals of the transfers of cutting rights in Quebec and Ontario, for proceeds of \$75 million (CDN\$80 million) plus elements of working capital of approximately \$42 million (CDN\$45 million). Domtar received 19% of the proceeds in shares of EACOM representing an approximate 12% ownership interest in EACOM. The sale resulted in a loss on disposal of the Wood Business and related pension curtailments and settlements of \$50 million. Starting in the third quarter of 2010, the investment of the Company in EACOM will be accounted for under the equity method.

The transaction included the sale of five operating sawmills: Timmins, Nairn Centre and Gogama in Ontario, and Val-d Or and Matagami in Quebec; as well as two non-operating sawmills: Ear Falls in Ontario and Ste-Marie in Quebec. The sawmills had approximately 3.5 million cubic meters of annual harvesting rights and a production capacity of close to 900 million board feet. Also included in the transaction was the Sullivan remanufacturing facility in Quebec and interests in two investments: Anthony-Domtar Inc. and Elk Lake Planning Mill Limited.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with Domtar Corporation's unaudited interim consolidated financial statements and notes thereto included elsewhere in this Quarterly Report. You should also read the MD&A in conjunction with the historical financial information contained in our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission (SEC) on February 26, 2010. Throughout this MD&A, unless otherwise specified, Domtar Corporation, the Company, Domtar, we, us and our refer to Domtar Corporation and its subsidiaries, as well as investments. Domtar Corporation's common stock is listed on the New York Stock Exchange and the Toronto Stock Exchange. Except where otherwise indicated, all financial information reflected herein is determined on the basis of accounting principles generally accepted in the United States (GAAP).

In accordance with industry practice, in this report, the term ton or the symbol ST refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tons. The term metric ton or the symbol ADMT refers to an air dry metric ton and the term MFBM refers to million foot board measure. In this report, unless otherwise indicated, all dollar amounts are expressed in U.S. dollars, and the term dollars and the symbol \$ refer to U.S. dollars. In the following discussion, unless otherwise noted, references to increases or decreases in income and expense items, prices, contribution to net earnings (loss), and shipment volume are based on the three-month and six-month periods ended June 30, 2010 as compared to the three-month period ended March 31, 2010 and the three-month and six-month periods ended June 30, 2009. The three-month and six-month periods ended June 30, 2010 and 2009 are also referred to as the second quarter of 2010 and 2009 and the first half or year-to-date of 2010 and 2009, respectively, and the three-month period ended March 31, 2010 as the first quarter of 2010.

EXECUTIVE SUMMARY

In the second quarter of 2010, we reported operating income of \$96 million, a decrease of \$20 million compared to operating income of \$116 million in the first quarter of 2010. The decrease was attributable to the loss on sale of our Wood Business of \$50 million recorded in the second quarter of 2010, as well as higher-than-average maintenance costs due to the timing of annual shutdowns at several of our mills. Also, there were no alternative fuel tax credits recorded in the second quarter of 2010 compared to \$25 million recorded in the first quarter of 2010. This decrease was partially offset by an improvement in our Papers segment in the second quarter of 2010, which experienced higher average selling prices for paper and pulp, compared to the first quarter of 2010, as well as a post-retirement curtailment gain of \$10 million recorded in the second quarter of 2010. Our strategy is to maintain our production levels in line with our customer demand. As a result of stronger market demand, we took no lack-of-order downtime and machine slowdowns in the second quarter of 2010 compared to 28,000 tons in the first quarter of 2010. The decrease in lack-of-order downtime and machine slowdowns positively impacted our earnings.

We expect third quarter paper shipments to be flat compared to the second quarter, before gradually declining towards year-end due to seasonal factors. Pulp shipments are forecast to be similar to the second quarter while selling prices for paper grade pulp will come under pressure. Costs related to planned maintenance shutdowns are expected to be materially reduced in the third quarter. Inflation on input costs is expected to be marginal for the second half of the year.

Restructuring activities

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

In July 2010, we announced our decision, which was made in the second quarter of 2010, to end all manufacturing activities at our forms converting plant in Cerritos, California. Operations ceased on July 16, 2010. Approximately 50 plant employees have been impacted by this decision.

In March 2010, we announced the permanent closure of our coated groundwood paper mill in Columbus, Mississippi. Operations ceased in April 2010. This measure resulted in the permanent curtailment of approximately 238,000 tons of coated groundwood production capacity per year as well as approximately 70,000 metric tons of thermo-mechanical pulp and affected approximately 219 employees.

Table of Contents

RECENT DEVELOPMENTS

Sale of Wood Business

On June 30, 2010, the Company sold its Wood Business to EACOM Timber Corporation (EACOM), following the consents and customary closing conditions, which included approvals of the transfers of cutting rights in Quebec and Ontario, for proceeds of \$75 million (CDN\$80 million) plus elements of working capital of approximately \$42 million (CDN\$45 million). We received 19% of the proceeds in shares of EACOM giving Domtar an approximate 12% ownership interest in EACOM. The sale resulted in a loss on disposal of the Wood Business and related pension curtailments and settlements of \$50 million. Starting in the third quarter of 2010, the investment in EACOM will be accounted for under the equity method.

The transaction included the sale of five operating sawmills: Timmins, Nairn Centre and Gogama in Ontario, and Val-d'Or and Matagami in Quebec; as well as two non-operating sawmills: Ear Falls in Ontario and Ste-Marie in Quebec. The sawmills had approximately 3.5 million cubic meters of annual harvesting rights and a production capacity of close to 900 million board feet. Also included in the transaction was the Sullivan remanufacturing facility in Quebec and our interests in two investments: Anthony-Domtar Inc. and Elk Lake Planning Mill Limited.

Dividend and Stock Repurchase Program

In June 2010, we declared a quarterly dividend of \$0.25 per share to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc., a subsidiary of Domtar Corporation. The total dividend of approximately \$11 million was paid on July 15, 2010 to shareholders of record on June 15, 2010.

On August 4, 2010, our Board of Directors approved our second quarterly dividend of \$0.25 per share to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc. This dividend is to be paid on October 15, 2010 to stockholders of record on September 15, 2010.

In addition, on May 4, 2010, our Board of Directors authorized a stock repurchase program of up to \$150 million of the Company's common stock. Under the stock repurchase 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 stock repurchase 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 stock repurchase 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, awards, and employee stock purchase plan and to improve shareholders' returns.

We made open market purchases of our common stock using general corporate funds. Additionally, we have entered into a structured stock repurchase arrangement with a large financial institution using general corporate funds in order to lower the average cost to acquire shares. The agreement requires the Company to make an up-front payment of \$10 million to the counterparty financial institution and will result in the receipt of either stock or cash at the maturity of the agreement in the third quarter of 2010, depending on market conditions.

During the second quarter of 2010, the Company repurchased 340,130 shares at an average price of \$55.79 for a cash cost totalling \$19 million.

All shares repurchased are recorded as treasury stock. Treasury stock is accounted for under the par value method. See Note 11 Shareholders Equity in the Notes to the consolidated financial statements for additional information.

Cellulosic Biofuel Credit

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

From January 1, 2009 until we started to claim the Alternative Fuel Tax Credits, we have approximately 200 million gallons of black liquor that may qualify for this CBPC that would represent approximately \$200 million of CBPC or approximately \$120 million of after tax benefit to the Corporation. In July 2010, we submitted an application with the IRS to be registered for the CBPC.

Edgar Filing: Domtar CORP - Form 10-Q

There is, however, a degree of uncertainty related to this credit as we have not received our registration for the credit and we believe there is some lack of clarity with the application of the IRS rules. As such, during the period ended June 30, 2010, we have not recorded any impact related to the CBPC.

OUR BUSINESS

Our reporting segments correspond to the following business activities: Papers, Paper Merchants and Wood. A description of our business is included in Part I, Item 1, Business of our Annual Report on Form 10-K for the year ended December 31, 2009.

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

The following table includes the consolidated financial results of Domtar Corporation for the second quarter and first half of 2010 and 2009.

FINANCIAL HIGHLIGHTS <i>(In millions of dollars, unless otherwise noted)</i>	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Sales	\$ 1,547	\$ 1,319	\$ 3,004	\$ 2,621
Operating income	96	139	212	117
Net earnings	31	48	89	3
Net earnings per common share (in dollars) ¹ :				
Basic	0.72	1.12	2.07	0.07
Diluted	0.71	1.12	2.05	0.07
Operating income (loss) per segment:				
Papers	\$ 149	\$ 150	\$ 269	\$ 144
Paper Merchants	(1)	1		3
Wood	(49)	(12)	(54)	(30)
Corporate	(3)		(3)	
Total	\$ 96	\$ 139	\$ 212	\$ 117
			At June 30, 2010	At December 31, 2009
Total assets			\$ 6,051	\$ 6,519
Total long-term debt, including current portion			\$ 1,216	\$ 1,712

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

Table of Contents**SECOND QUARTER 2010 VERSUS****SECOND QUARTER 2009****Sales**

Sales for the second quarter of 2010 amounted to \$1,547 million, an increase of \$228 million, or 17%, from sales of \$1,319 million in the second quarter of 2009. The increase in sales was mainly attributable to higher average selling prices for paper and pulp (\$183 million) and wood (\$13 million), as well as higher shipments for wood (\$22 million).

Cost of Sales, excluding Depreciation and Amortization

Cost of sales, excluding depreciation and amortization, amounted to \$1,207 million in the second quarter of 2010, an increase of \$91 million, or 8%, compared to cost of sales, excluding depreciation and amortization, of \$1,116 million in the second quarter of 2009. This increase was mainly attributable to higher shipments for wood (\$18 million) and higher deliveries for merchants (\$9 million), higher-than-average maintenance costs due to the timing of annual shutdowns at several of our mills (\$42 million), higher fiber costs (\$18 million), higher freight costs (\$12 million) and the negative impact of a stronger Canadian dollar on our Canadian denominated expenses, net of our hedging program (\$14 million). These factors were partially offset by lower costs for chemicals (\$22 million) and energy (\$13 million).

Depreciation and Amortization

Depreciation and amortization amounted to \$101 million in the second quarter of 2010, a decrease of \$3 million, or 3%, compared to depreciation and amortization of \$104 million in the second quarter of 2009. The decrease is primarily due to the write-down of property, plant and equipment due to the permanent closure of a paper machine and manufacturing equipment in the first and last quarters of 2009 at our Plymouth pulp and paper mill, partially offset by the negative impact of a stronger Canadian dollar in the second quarter of 2010 when compared to the second quarter of 2009.

Selling, General and Administrative Expenses (SG&A)

SG&A expenses amounted to \$69 million in the second quarter of 2010, a decrease of \$17 million, or 20%, compared to SG&A expenses of \$86 million in the second quarter of 2009. The decrease in SG&A is primarily due to a post-retirement curtailment gain of \$10 million related to the harmonization of certain of our post-retirement benefit plans, as well as lower costs related to our variable compensation program of \$9 million. These factors were partially offset by the negative impact of a stronger Canadian dollar in the second quarter of 2010 when compared to 2009.

Other Operating Loss (Income)

Other operating loss amounted to \$55 million in the second quarter of 2010, a decrease in other operating income of \$187 million compared to other operating income of \$132 million in the second quarter of 2009. This decrease in other operating income is primarily due to a decrease in the refundable excise tax credit for the production and use of alternative bio fuel mixtures of \$131 million recognized in the second quarter of 2009 as well as due to a loss on sale of our Wood Business of \$50 million recorded in the second quarter of 2010.

Operating Income

Operating income in the second quarter of 2010 amounted to \$96 million, a decrease of \$43 million compared to an operating income of \$139 million in the second quarter of 2009. This decrease in operating income is attributable to the factors mentioned above as well as higher impairment and write-down of property, plant and equipment and closure and restructuring costs (\$13 million) primarily due to accelerated depreciation related to our Plymouth, North Carolina mill, reconfiguration announced in the fourth quarter of 2009.

Interest Expense

We incurred \$70 million of interest expense in the second quarter of 2010, an increase of \$47 million compared to interest expense of \$23 million in the second quarter of 2009. The increase in interest expense is primarily related to a charge of \$40 million incurred on the repurchase of the 5.375% and 7.125% Notes in the second quarter of 2010, which included tender premiums of \$25 million and a loss on the reversal of a fair value decrement of \$14 million, as compared to a gain of \$15 million related to the repurchase of the 7.875% Notes in the

Edgar Filing: Domtar CORP - Form 10-Q

second quarter of 2009. This increase was partially offset by a lower long-term debt balance outstanding in the second quarter of 2010 compared to the second quarter of 2009.

Table of Contents**Income Taxes**

For the second quarter of 2010, our income tax benefit amounted to \$5 million, which was comprised of current tax expense of \$7 million and deferred tax benefit of \$12 million compared to an income tax expense of \$68 million in the second quarter of 2009, which was comprised of current tax benefit of \$6 million and deferred tax expense of \$74 million. We made income tax payments of \$4 million during the second quarter of 2010 and received a \$368 million excise tax refund, net of federal income tax offsets. In the second quarter of 2010, our effective tax rate was a benefit of 19% compared to an effective tax rate of 59% in the second quarter of 2009. The effective tax rate for the second quarter of 2010 was affected by a change in our forecasted earnings by jurisdiction as well as the utilization of Canadian tax attributes that have had a valuation allowance recorded against them in prior periods. The actual effective tax rate of future interim periods in 2010 could be impacted by a change in the forecasted ratio of separate Canadian income or loss to total consolidated income or loss throughout 2010.

Net Earnings

Net earnings amounted to \$31 million (\$0.71 per common share on a diluted basis) in the second quarter of 2010, a decrease of \$17 million compared to net earnings of \$48 million (\$1.12 per common share on a diluted basis) in the second quarter of 2009 due to the factors mentioned above.

FIRST HALF 2010 VERSUS**FIRST HALF 2009****Sales**

Sales for the first half of 2010 amounted to \$3,004 million, an increase of \$383 million, or 15%, from sales of \$2,621 million in the first half of 2009. The increase in sales was mainly attributable to higher prices and shipments for pulp (\$223 million and \$83 million, respectively), as well as higher prices and shipments for wood (\$17 million and \$41 million, respectively).

Cost of Sales, Excluding Depreciation and Amortization

Cost of sales, excluding depreciation and amortization, amounted to \$2,349 million in the first half of 2010, an increase of \$110 million, or 5%, compared to cost of sales, excluding depreciation and amortization, of \$2,239 million in the first half of 2009. This increase was mainly attributable to higher shipments for paper and wood (\$68 million and \$36 million, respectively), higher-than-average maintenance costs due to the timing of annual shutdowns at several of our mills (\$42 million), higher fiber costs (\$15 million), higher freight costs (\$14 million) and the negative impact of a stronger Canadian dollar on our Canadian denominated expenses, net of our hedging program (\$21 million). These factors were partially offset by lower costs for chemicals (\$49 million) and energy (\$18 million).

Depreciation and Amortization

Depreciation and amortization amounted to \$203 million in the first half of 2010, unchanged as compared to depreciation and amortization of \$203 million in the first half of 2009. Depreciation and amortization were impacted by the write-down of property, plant and equipment due to the permanent closure of a paper machine and manufacturing equipment in the first and last quarters of 2009 at our Plymouth pulp and paper mill, offset by the negative impact of a stronger Canadian dollar in the first half of 2010 when compared to the first half of 2009.

Selling, General and Administrative Expenses

SG&A expenses amounted to \$153 million in the first half of 2010, a decrease of \$16 million, or 9%, compared to SG&A expenses of \$169 million in the first half of 2009. The decrease in SG&A is primarily due to a post-retirement curtailment gain of \$10 million related to the harmonization of certain of our post-retirement benefit plans, as well as lower costs related to our variable compensation program of \$7 million. These factors were partially offset by the negative impact of a stronger Canadian dollar in the first half of 2010 when compared to the first half of 2009.

Table of Contents

Other Operating Loss (Income)

Other operating loss amounted to \$26 million in the first half of 2010, a decrease in other operating income of \$198 million compared to other operating income of \$172 million in the first half of 2009. This decrease in other operating income is primarily due to a refundable excise tax credit for the production and use of alternative bio fuel mixtures of \$25 million recognized in the first half of 2010 compared to \$177 million recognized in the first half of 2009, as well as due to a loss on sale of our Wood Business of \$50 million recorded in the first half of 2010.

Operating Income

Operating income in the first half of 2010 amounted to \$212 million, an increase of \$95 million compared to operating income of \$117 million in the first half of 2009, in part due to the factors mentioned above and lower closure and restructuring costs of \$5 million in the first half of 2010.

Interest Expense

We incurred \$102 million of interest expense in the first half of 2010, an increase of \$48 million compared to interest expense of \$54 million in the first half of 2009. This increase in interest expense is mainly due to a charge of \$40 million incurred on the repurchase of the 5.375% and 7.125% Notes in the second quarter of 2010, which included tender premiums of \$25 million and a loss on the reversal of a fair value decrement of \$14 million, as compared to a gain of \$15 million related to the repurchase of the 7.875% Notes in the second quarter of 2009. This increase was partially offset by a lower long-term debt balance outstanding in the first half of 2010 compared to the first half of 2009.

Income Taxes

For the first half of 2010, our income tax expense amounted to \$21 million, which was comprised of current tax expense of \$18 million and deferred tax expense of \$3 million compared to an income tax expense of \$60 million in the first half of 2009, which was comprised of current tax expense of \$1 million and deferred tax expense of \$59 million. We made income tax payments of \$3 million during the first half of 2010 and received a \$368 million excise tax refund, net of federal income tax offsets. In the first half of 2010, our effective tax rate was 19% compared to 95% in the first half of 2009. The effective tax rate for the first half of 2010 was affected by a change in the forecasted earnings by jurisdiction as well as the utilization of Canadian tax attributes that have had a valuation allowance recorded against them in prior periods. The actual effective tax rate of future interim periods in 2010 could be impacted by a change in the forecasted ratio of separate Canadian income or loss to total consolidated income or loss throughout 2010.

Net Earnings

Net earnings amounted to \$89 million (\$2.05 per common share on a diluted basis) in the first half of 2010, an increase of \$86 million compared to net earnings of \$3 million (\$0.07 per common share on a diluted basis) in the first half of 2009, mainly due to the factors mentioned above.

Table of Contents**PAPERS**

SELECTED INFORMATION <i>(In millions of dollars, unless otherwise noted)</i>	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Sales				
Total sales	\$ 1,317	\$ 1,127	\$ 2,562	\$ 2,233
Intersegment sales	(60)	(55)	(122)	(115)
	\$ 1,257	\$ 1,072	\$ 2,440	\$ 2,118
Operating income	\$ 149	\$ 150	\$ 269	\$ 144
Shipments				
Paper (in thousands of ST)	891	929	1,851	1,842
Pulp (in thousands of ADMT)	486	393	874	707

Sales and Operating Income*Sales*

Sales in our Papers segment amounted to \$1,257 million in the second quarter of 2010, an increase of \$185 million, or 17%, compared to sales of \$1,072 million in the second quarter of 2009. The increase in sales is mostly attributable to higher average selling prices for paper and pulp as well as higher shipments for pulp of approximately 24%, reflecting stronger market demand for pulp. As a result of stronger market demand, we took no lack-of-order downtime and machine slowdowns in the second quarter of 2010 compared to 101,000 tons of paper in the second quarter of 2009. These factors were partially offset by lower shipments for paper of approximately 4%.

For the first half of 2010, sales in our Papers segment increased by \$322 million, or 15%, compared to the first half of 2009. The increase in sales is mainly due to the factors mentioned above.

Operating Income

Operating income in our Papers segment amounted to \$149 million in the second quarter of 2010, a decrease of \$1 million, when compared to an operating income of \$150 million in the second quarter of 2009. The decrease is mostly attributable to no alternative fuel tax credits being recorded in the second quarter of 2010 compared to \$131 million recorded in the second quarter of 2009, to the write-down of property, plant and equipment of \$14 million recorded in the second quarter of 2010 compared to none recorded in the second quarter of 2009 and to the unfavorable impact of a stronger Canadian dollar. This decrease was partially offset by higher average selling prices for paper, as well as significantly higher average selling prices and shipments for pulp. Also, the decrease was partially offset by a \$9 million adjustment related to our variable compensation program as well as a post-retirement curtailment gain of \$10 million related to the harmonization of certain of our post-retirement benefit plans.

For the first half of 2010, operating income in our Papers segment increased by \$125 million, or 87%, compared to the first half of 2009. The increase is mostly attributable to higher average selling prices and shipments for paper and pulp, to a post-retirement curtailment gain of \$10 million related to the harmonization of certain of our post-retirement benefit plans and to a \$7 million adjustment related to our variable compensation program. This increase is partially offset by alternative fuel tax credits of \$25 million for the first half of 2010 compared to \$177 million in the first half of 2009, as well as by the unfavorable impact of a stronger Canadian dollar.

Table of Contents

Pricing Environment

Overall average paper sales prices increased in the second quarter of 2010 compared to the second quarter of 2009. Our sales prices for offset 50 lb rolls were higher by \$61/ton, or 7% in the second quarter of 2010 compared to 2009, while our copy 20 lb sheets were higher by \$36/ton, or 3% in the second quarter of 2010 compared to 2009. For the first half of 2010, our average paper sales prices increased when compared to the first half of 2009. Our sales prices for offset 50 lb rolls were higher by \$14/ton, or 2% in the first half of 2010 compared to the first half of 2009, while our sales prices for copy 20 lb sheets were higher by \$30/ton, or 2%, in the first half of 2010 compared to the first half of 2009.

Our average pulp sales prices experienced a large increase in the second quarter of 2010 compared to the second quarter of 2009. Our sales price on both Northern Bleached Softwood Kraft (NBSK) pulp and Northern Bleached Hardwood Kraft (NBHK) pulp increased by \$321/metric ton and \$372/metric ton, or 65% and 94%, respectively, in the second quarter of 2010 compared to the second quarter of 2009.

Operations

Shipments

Our paper shipments decreased by 38,000 tons, or 4%, in the second quarter of 2010 compared to the second quarter of 2009, primarily due to the closure of our Columbus paper mill and the exit of the coated groundwood market. For the first half of 2010, our paper shipments increased by 9,000 tons when compared to the first half of 2009.

Our pulp trade shipments increased by 93,000 metric tons, or 24%, in the second quarter of 2010 compared to the second quarter of 2009. The increase in pulp shipments resulted mostly from an increase in market demand. For the first half of 2010, our pulp trade shipments increased by 167,000 metric tons, or 24%, when compared to the first half of 2009, and were impacted by the factors mentioned above.

Alternative Fuel Tax Credits

The U.S. Internal Revenue Code of 1986, as amended (the Code) permits a refundable excise tax credit, until the end of 2009, for the production and use of alternative bio fuel mixtures derived from biomass. We submitted an application with the IRS to be registered as an alternative fuel mixer and received notification that our registration had been accepted in March 2009. We began producing and consuming alternative fuel mixtures in February 2009 at our eligible mills. We received a \$140 million refund in 2009 and another \$368 million refund, net of federal income tax offsets, in the second quarter of 2010. We recorded in Other operating loss (income) no tax credit in the second quarter of 2010 and \$25 million in tax credits in the first half of 2010 compared to \$131 million in tax credits in the second quarter 2009 and \$177 million in tax credits in the first half of 2009. The \$25 million recorded in the first half of 2010 represented an adjustment to amounts presented as deferred revenue at December 31, 2009. The \$25 million was released to income following guidance issued by the IRS in March 2010. We recorded no taxes in the second quarter of 2010 and an income tax expense of \$7 million in the first half of 2010 compared to \$52 million in the second quarter of 2009 and \$70 million in the first half of 2009 related to the alternative fuel mixture income.

Labor

We have an umbrella agreement with the United Steelworkers Union, expiring in 2012, affecting approximately 4,000 employees at our U.S. locations. This agreement only covers certain economic elements, and all other issues will be negotiated at each operating location, as the related collective bargaining agreements become subject to renewal. The parties have agreed not to strike or lock-out during the terms of the respective local agreements.

We have four collective agreements that will expire in 2010, one of which expired in April at our Windsor facility, two that expired in May at our Nekoosa facility and one that expires in August at our Hawesville facility. Negotiations have not started for these collective agreements.

Table of Contents

Closure and Restructuring

In July 2010, we announced our decision, which was made in the second quarter of 2010, to end all manufacturing activities at our forms converting plant in Cerritos, California. Operations ceased on July 16, 2010. Approximately 50 plant employees have been impacted by this decision.

In March 2010, we announced the permanent shut down of the Columbus coated groundwood paper mill, which occurred at the end of April 2010, due to unfavorable market conditions. This measure resulted in the permanent curtailment of approximately 238,000 tons of coated groundwood, and 70,000 metric tons of thermo-mechanical pulp, and affects 219 employees.

In the second quarter of 2010, we incurred \$5 million of closure and restructuring costs compared to \$4 million in the second quarter of 2009 and for the first half of 2010, we incurred \$61 million, including the impairment and write-down of property, plant and equipment of \$36 million compared to \$61 million in the first half of 2009, including the impairment and write-down of property, plant and equipment of \$35 million.

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

Other

Natural Resources Canada Pulp and Paper Green Transformation Program

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

Subject to the approval of Natural Resources Canada, eligible projects must demonstrate an environmental benefit by either improving energy efficiency or increasing renewable energy production. The investment must be made before the expiration of the program on March 31, 2012, and all projects are subject to the approval of the Government of Canada. Although amounts will not be received until qualifying capital expenditures have been made, we have been allocated \$135 million (CDN\$143 million) through this Program, of which, \$76 million (CDN\$81 million) have been approved to date. The funds are to be spent on capital projects to improve energy efficiency and environmental performance in our Canadian pulp and paper mills and any amounts received will be accounted for as an offset to the applicable plant and equipment asset amount. As of July 2010, we have received \$30 million (CDN\$31 million) related to two eligible projects at our Kamloops and Dryden pulp mills.

Table of Contents**PAPER MERCHANTS**

SELECTED INFORMATION (In millions of dollars)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Sales	\$ 213	\$ 205	\$ 425	\$ 422
Operating (loss) income	(1)	1		3
Sales and Operating (Loss) Income				

Sales

Sales in our Paper Merchants segment amounted to \$213 million in the second quarter of 2010, an increase of \$8 million, or 4%, compared to sales of \$205 million in the second quarter of 2009. This increase in sales was mostly attributable to an increase in deliveries of approximately 5%.

For the first half of 2010, sales in our Paper Merchants segment increased by \$3 million, or 1%, when compared to the first half of 2009, primarily due to the factor mentioned above.

Operating (Loss) Income

Operating loss amounted to \$1 million in the second quarter of 2010, a decrease of \$2 million when compared to operating income of \$1 million in the second quarter of 2009. The decrease in operating income is primarily the result of margins temporarily contracting due to supplier price increases in the second quarter of 2010 when compared to the second quarter of 2009, partially offset by the increase in sales mentioned above.

For the first half of 2010, operating income in our Paper Merchants segment decreased by \$3 million when compared to the first half of 2009, primarily due to the factors mentioned above.

Operations*Labor*

We have collective agreements covering six locations in the U.S., of which two will expire in 2010, two in 2011 and two in 2013. We have five collective agreements covering four locations in Canada, one of which expired in 2008 and two expired in 2009 (negotiations are expected to begin shortly) and two will expire in 2010.

Table of Contents**WOOD**

SELECTED INFORMATION (In millions of dollars, unless otherwise noted)	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Sales				
Total sales	\$ 83	\$ 46	\$ 150	\$ 89
Intersegment sales	(6)	(4)	(11)	(8)
	\$ 77	\$ 42	\$ 139	\$ 81
Operating loss	(\$ 49)	(\$ 12)	(\$ 54)	(\$ 30)
Shipments (millions of FBM)	187	135	351	260
Benchmark prices¹:				
Lumber G.L. 2x4x8 stud (\$/MFBM)	\$ 359	\$ 245	\$ 348	\$ 237
Lumber G.L. 2x4 R/L no. 1 & no. 2 (\$/MFBM)	357	258	350	249

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

Sales and Operating Loss*Sales*

Sales in our Wood segment amounted to \$77 million in the second quarter of 2010, an increase of \$35 million, or 83%, compared to sales of \$42 million in the second quarter of 2009. The increase in sales is attributable to higher average selling prices and higher shipments for wood products.

For the first half of 2010, sales in our Wood segment increased by \$58 million, or 72%, when compared to the first half of 2009. This increase in sales is attributable to the factors mentioned above.

Operating Loss

Operating loss in our Wood segment amounted to \$49 million in the second quarter of 2010, an increase in operating loss of \$37 million compared to an operating loss of \$12 million in the second quarter of 2009. Our operating loss was impacted by a \$50 million loss on the sale of our Wood Business in the second quarter of 2010 and by the unfavorable impact of a stronger Canadian dollar. This increase was partially offset by higher shipments, as well as higher average selling prices of our wood products.

For the first half of 2010, operating loss in our Wood segment increased by \$24 million compared to the first half of 2009, primarily due to the factors mentioned above.

Pricing Environment

Our average sales price for Great Lakes 2x4 stud lumber increased by \$117/MFBM, or 59%, and our average sales price for Great Lakes 2x4 random length lumber increased by \$106/MFBM, or 50%, in the second quarter of 2010 compared to the second quarter of 2009. For the first half of 2010, our average sales prices for Great Lakes 2x4 stud lumber increased by \$115/MFBM, or 61%, and our average sales price for Great Lakes 2x4 random length lumber increased by \$108/MFBM, or 54%, when compared to the first half of 2009.

Operations

Shipments

Our lumber and wood shipments in the second quarter of 2010 increased by 52 MFBM, or 39%, compared to shipments in the second quarter of 2009, primarily due to the increased activity in the U.S. housing industry and a significant decrease in the supply of lumber in the market. Our lumber and wood shipments in the first half of 2010 increased by 91 MFBM, or 35%, compared to shipments in the first half of 2009, primarily due to the factors mentioned above.

Table of Contents

STOCK-BASED COMPENSATION EXPENSE (INCOME)

For the second quarter and the first half of 2010, compensation expense (income) recognized in our results of operations was approximately \$(2) million and \$4 million, respectively, compared to \$7 million and \$11 million recognized in the second quarter and the first half of 2009, respectively. 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 including 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 revolving credit facility. Our liquidity requirements can be satisfied by drawing upon our contractually committed revolving credit facility, of which \$701 million is currently undrawn and available. Under extreme market conditions, there can be no assurance that this agreement would be available or sufficient. See "Capital Resources" below.

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

Operating Activities

Cash flows provided from operating activities totaled \$733 million in the first half of 2010, an increase of \$370 million compared to cash flows provided from operating activities of \$363 million in the first half of 2009. This increase in cash flows provided from operating activities is primarily related to the \$368 million cash received in the second quarter of 2010 with regards to the alternative fuel tax credits as well as increased profitability. This was partially offset by an increase in receivables resulting from higher sales volumes in the second quarter of 2010 as compared to the fourth quarter of 2009.

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

Investing Activities

Cash flows provided from investing activities in the first half of 2010 amounted to \$37 million, an increase of \$78 million compared to cash flows used for investing activities of \$41 million in the first half of 2009. This increase is primarily related to the proceeds from the sale of our Wood Business of \$97 million, as well as higher proceeds from disposals of certain property, plant and equipment of \$13 million, offset by higher capital spending of \$32 million in the first half of 2010 when compared to 2009.

We intend to limit our annual capital expenditures to below 50% of annual depreciation expense in 2010, excluding the spending under the Natural Resources Canada Pulp and Paper Green Transformation Program, for which we expect to be reimbursed.

Financing Activities

Cash flows used for financing activities totaled \$581 million in the first half of 2010 compared to cash flows provided from financing activities of \$34 million in the first half of 2009. This \$615 million increase in cash flows used for financing activities is mainly attributable to the repurchase of \$425 million of our 5.375% and 7.125% Notes in the second quarter of 2010 and the repayment of \$102 million of our tranche B term loan in the first quarter of 2010, as well as a common stock repurchase of \$19 million and a structured share repurchase advance of \$10 million. This was partially offset by borrowings under our accounts receivable securitization program of \$20 million. This compares to the repurchase of our 7.875% Notes of approximately \$400 million, the issuance of long-term debt of \$385 million, the additional borrowings of \$90 million under our revolving credit facility and the repayments of \$3 million of our long-term debt in the first half of 2009.

Table of Contents**Capital Resources**

Net indebtedness, consisting of bank indebtedness and long-term debt, net of cash and cash equivalents, was \$732 million at June 30, 2010, compared to \$1,431 million at December 31, 2009. The \$699 million decrease in net indebtedness is primarily due to a higher cash level, as well as the repurchase of \$425 million of our 5.375% and 7.125% Notes in the second quarter of 2010 and a repayment of \$102 million of our tranche B term loan during the first quarter of 2010. This was offset by borrowings under our accounts receivable securitization program of \$20 million.

Our Credit Agreement consists of a \$232 million senior secured tranche B term loan (remaining outstanding balance at June 30, 2010) and a \$750 million senior secured revolving credit facility. The revolving credit facility may be used by the Company, Domtar Paper Company, LLC and Domtar Inc. for general corporate purposes and a portion is available for letters of credit. Borrowings by the Company and Domtar Paper Company, LLC under the revolving credit facility are available in U.S. dollars, and borrowings by Domtar Inc. under the revolving credit facility are available in U.S. dollars and/or Canadian dollars and are limited to \$150 million (or the Canadian dollar equivalent thereof).

The tranche B term loan facility matures on March 7, 2014, and the revolving credit facility matures on March 7, 2012. The tranche B term loan amortizes in nominal quarterly installments (equal to one percent of the aggregate initial principal amount thereof per annum) with the balance due on the maturity date. In addition, under certain conditions and to the extent we generate cash flow in excess of cash flow used for operating and capital requirements and repayments of debt, excluding optional repayments of the term loan, we are obligated to apply a portion of such calculated excess cash flow amount towards repayments of the term loan, which amount would include any repayments of the term loan already made.

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

The Credit Agreement contains a number of covenants that, among other things, limit the ability of the Company and its subsidiaries to make capital expenditures and place restrictions on other matters customarily restricted in senior secured credit facilities, including restrictions on indebtedness (including guarantee obligations), liens (including sale and leasebacks), fundamental changes, sales or disposition of property or assets, investments (including loans, advances, guarantees and acquisitions), transactions with affiliates, hedge agreements, changes in fiscal periods, environmental activity, optional payments and modifications of other material debt instruments, negative pledges and agreements restricting subsidiary distributions and changes in lines of business. As long as the revolving credit commitments are outstanding, we are required to comply with a consolidated EBITDA (as defined under the Credit Agreement) to consolidated cash interest coverage ratio of greater than 2.5x and a consolidated debt to consolidated EBITDA (as defined under the Credit Agreement) ratio of less than 4.5x. The Credit Agreement contains customary events of default, provided that non-compliance with the consolidated cash interest coverage ratio or consolidated leverage ratio will not constitute an event of default under the tranche B term loan facility unless it has not been waived by the revolving credit lenders within a period of 45 days after notice. At June 30, 2010, we were in compliance with our covenants.

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

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

The Company's direct and indirect, existing and future, U.S. 100% owned subsidiaries serve as guarantors of the senior secured credit facilities for any obligations thereunder of the U.S. borrowers, subject to agreed exceptions. The Company and its subsidiaries serve as guarantors of Domtar Inc.'s obligations as a borrower under the senior secured credit facilities, subject to agreed exceptions. Domtar Inc. does not guarantee Domtar Corporation's obligations under the Credit Agreement.

Table of Contents

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

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

As of June 30, 2010, there was \$1 million outstanding as an overdraft recorded in Bank indebtedness under our revolving credit facility (December 31, 2009 \$6 million outstanding as overdraft recorded in Bank indebtedness). In addition, at June 30, 2010, we had outstanding letters of credit amounting to \$48 million under this credit facility (December 31, 2009 \$53 million). We have no other outstanding letters of credit (December 31, 2009 nil).

Domtar Canada Paper Inc. Exchangeable Shares

Upon the consummation of the March 7, 2007 transaction, Domtar Inc. shareholders had the option to receive either common stock of the Company or shares of Domtar (Canada) Paper Inc. that are exchangeable for common stock of the Company. As of June 30, 2010, there were 923,925 exchangeable shares issued and outstanding. The exchangeable shares of Domtar (Canada) Paper Inc. are intended to be substantially the economical equivalent to shares of the Company's common stock. These shareholders may exchange the exchangeable shares for shares of Domtar Corporation common stock on a one-for-one basis at any time. The exchangeable shares may be redeemed by Domtar (Canada) Paper Inc. on a redemption date to be set by the Board of Directors, which cannot be prior to July 31, 2023, or upon the occurrence of certain specified events, including, upon at least 60 days prior written notice to the holders, in the event less than 416,667 exchangeable shares (excluding any exchangeable shares held directly or indirectly by us) are outstanding at any time.

OFF BALANCE SHEET ARRANGEMENTS

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

Table of Contents**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 June 30, 2010, we are unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provision has been recorded. These indemnifications have not yielded significant expenses in the past.

Tax Sharing Agreement

In conjunction with the March 7, 2007 transaction, we signed a Tax Sharing Agreement that governs both our and Weyerhaeuser rights and obligations after the Transaction with respect to taxes for both pre and post-Distribution periods in regards to ordinary course taxes, and also covers related administrative matters. The Distribution refers to the distribution of shares of the Company to Weyerhaeuser shareholders. We will generally be required to indemnify Weyerhaeuser and Weyerhaeuser shareholders against any tax resulting from the Distribution if that tax results from an act or omission to act by us after the Distribution. If Weyerhaeuser, however, should recognize a gain on the Distribution for reasons not related to an act or omission to act by the Company after the Distribution, Weyerhaeuser would be responsible for such taxes and would not be entitled to indemnification by us under the Tax Sharing Agreement.

Pension Plans

We have indemnified and held harmless the trustees of our pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions from us or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. At June 30, 2010, we had not recorded a liability associated with these indemnifications, as we do not expect to make any payments pertaining to these indemnifications.

E.B. Eddy Acquisition

On July 31, 1998, Domtar Inc. (now a 100% owned subsidiary of Domtar Corporation) acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement includes a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of Domtar Inc. in specified circumstances, Domtar Inc. may be required to pay an increase in consideration of up to a maximum of \$113 million (CDN\$120 million), an amount gradually declining over a 25-year period. At March 7, 2007, the maximum amount of the purchase price adjustment was approximately \$104 million (CDN\$110 million). No provision was recorded for this potential purchase price adjustment.

On March 14, 2007, we received a letter from George Weston Limited (the previous owner of E.B. Eddy and a party to the purchase agreement) demanding payment of \$104 million (CDN\$110 million) as a result of the consummation of the Transaction. On June 12, 2007, an action was commenced by George Weston Limited against Domtar Inc. in the Superior Court of Justice of the Province of Ontario, Canada, claiming that the consummation of the Transaction triggered the purchase price adjustment and sought a purchase price adjustment of \$104 million (CDN\$110 million) as well as additional compensatory damages. We do not believe that the consummation of the Transaction triggers an obligation to pay an increase in consideration under the purchase price adjustment and intend to defend ourselves vigorously against any claims with respect thereto. However, we may not be successful in our defense of such claims, and if we are ultimately required to pay an increase in consideration, such payment may have a material adverse effect on our financial position, results of operations or cash flows.

CONTRACTUAL OBLIGATIONS

In the normal course of business, we enter into certain contractual obligations. The following table provides an update to our Notes obligations at June 30, 2010:

Edgar Filing: Domtar CORP - Form 10-Q

CONTRACT TYPE <i>(in million of dollars)</i>	2010	2011	2012	2013	2014	THEREAFTER	TOTAL
Notes	\$ 4	\$ 143	\$ 8	\$ 82	\$ 204	\$ 738	\$ 1,179

Table of Contents

RECENT ACCOUNTING PRONOUNCEMENTS

Accounting Changes Implemented

Transfers of financial assets

In June 2009, the Financial Accounting Standards Board (FASB) issued Accounting for Transfers of Financial Assets, which amends the derecognition guidance required by the Transfers and Servicing Topic of FASB Accounting Standards Codification (ASC). Some of the major changes undertaken by this amendment include:

Eliminating the concept of a Qualified Special Purpose Entity (QSPE).

Modifying the derecognition provisions as required by the Transfers and Servicing Topic of FASB ASC:

require that all arrangements made in connection with a transfer of financial assets be considered in the derecognition analysis,

clarify when a transferred asset is considered legally isolated from the transferor,

modify the requirements related to a transferee s ability to freely pledge or exchange transferred financial assets, and

provide guidance on when a portion of a financial asset can be derecognized, thereby restricting the circumstances when sale accounting can be achieved to the following cases:

transfers of individual or groups of financial assets in their entirety and

transfers of participating interests.

The new amendment is effective for financial asset transfers occurring after the beginning of an entity s first fiscal year that begins after November 15, 2009. The Company adopted the new requirements on January 1, 2010. The adoption of the new guidance resulted in an increase in Subordinated interest in securitized receivables of \$20 million presented in Receivables and a corresponding increase in Long-term debt due within one year in the Consolidated Balance Sheet.

Variable interest entities

In June and December 2009, the FASB issued guidance which requires an enterprise to perform an analysis to determine whether the enterprise s variable interest or interests give it a controlling financial interest in a variable interest entity. This guidance is effective for fiscal years beginning after November 15, 2009, and for interim and annual reporting periods thereafter. The Company adopted the new requirements on January 1, 2010 with no significant impact as the Company has no interests in variable interest entities.

Future Accounting Changes

Stock Compensation

Edgar Filing: Domtar CORP - Form 10-Q

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

This update is effective for fiscal years and interim periods beginning on or after December 15, 2010 with early adoption permitted. The adoption of this update will have no impact on the Company's consolidated financial statements.

CRITICAL ACCOUNTING POLICIES

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

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

We have included in our Annual Report on Form 10-K for the year ended December 31, 2009, a discussion of these critical accounting policies, which are important to the understanding of our financial condition and results of operations and require management's judgments. We did not make any changes to these critical accounting policies during the second quarter of 2010.

Table of Contents

FORWARD-LOOKING STATEMENTS

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

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

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

product selling prices;

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

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

the level of competition from domestic and foreign producers;

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

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

transportation costs;

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

legal proceedings;

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

Edgar Filing: Domtar CORP - Form 10-Q

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

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

performance of pension fund investments and related derivatives; and

the other factors described under Risk Factors, in item 1A of the Annual Report on Form 10-K, for the year ended December 31, 2009.

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 Annual Report on Form 10-K. Unless specifically required by law, Domtar Corporation assumes no obligation to update or revise these forward-looking statements to reflect new events or circumstances.

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

Information relating to quantitative and qualitative disclosure about market risk is contained in our Annual Report on Form 10-K for the year ended December 31, 2009. There has not been any material change in our exposure to market risk since December 31, 2009. In the second quarter of 2010, we have updated the following disclosure.

COST RISK**Cash flow hedges**

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

The following table presents the volumes under derivative financial instruments for natural gas contracts outstanding as of June 30, 2010 to hedge forecasted purchases:

Commodity	Notional contractual quantity under derivative contracts		Notional contractual value under derivative contracts (in millions of dollars)	Percentage of forecasted purchases under derivative contracts for			
				2010	2011	2012	2013
Natural gas	6,555,000	MMBTU ⁽¹⁾	\$ 46	29%	21%	7%	1%

(1) MMBTU: Millions of British thermal units

The natural gas derivative contracts were fully effective for accounting purposes as of June 30, 2010. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the second quarter and first half of 2010 resulting from hedge ineffectiveness (second quarter and first half of 2009 nil).

Table of Contents**FOREIGN CURRENCY RISK****Cash flow hedges**

We have manufacturing operations in the United States and Canada. As a result, we are exposed to movements in the foreign currency exchange rate in Canada. Also, certain assets and liabilities are denominated in Canadian dollars and are exposed to foreign currency movements. As a result, our earnings are affected by increases or decreases in the value of the Canadian dollar relative to the U.S. dollar. Our risk management policy allows us to hedge a significant portion of our exposure to fluctuations in foreign currency exchange rates for periods up to three years. We may use derivative instruments (currency options and foreign exchange forward contracts) to mitigate our exposure to fluctuations in foreign currency exchange rates. Foreign exchange forward contracts are contracts whereby we have the obligation to buy Canadian dollars at a specific rate. Currency options purchased are contracts whereby we have the right, but not the obligation, to buy Canadian dollars at the strike rate if the Canadian dollar trades above that rate. Currency options sold are contracts whereby we have the obligation to buy Canadian dollars at the strike rate if the Canadian dollar trades below that rate.

We formally document the relationship between hedging instruments and hedged items, as well as our risk management objectives and strategies for undertaking the hedge transactions. Foreign exchange forward contracts and currency options contracts used to hedge a portion of the forecasted purchases in Canadian dollars are designated as cash flow hedges. Current contracts are used to hedge forecasted purchases over the next 12 months. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded as a component of Accumulated other comprehensive loss within Shareholders' equity, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

The following table presents the currency values under contracts pursuant to currency options outstanding as of June 30, 2010 to hedge forecasted purchases:

Contract		Notional contractual value	Percentage of CDN denominated forecasted expenses, net of revenues, under contracts for	
			2010	2011
			Currency options purchased	CDN
Currency options sold	CDN	\$ 360	55%	18%

The currency options are fully effective as at June 30, 2010. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings for the second quarter and first half of 2010 resulting from hedge ineffectiveness (second quarter and first half of 2009 nil).

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

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As of June 30, 2010, 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 June 30, 2010, our disclosure controls and procedures were effective to provide reasonable assurance.

Change in Internal Control over Financial Reporting

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

PART II. OTHER INFORMATION**ITEM 1. LEGAL PROCEEDINGS**

A discussion of material developments in the Company's litigation and settlement matters occurring in the period covered by this report is found in Note 12 to the financial statements in this Quarterly Report on Form 10-Q.

ITEM 1A. RISK FACTORS

Our Annual Report on Form 10-K for the year ended December 31, 2009, contains important risk factors that could cause our actual results to differ materially from those projected in any forward-looking statement. There were no material changes to the risk factors described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, except:

On April 29, 2010, the Environmental Protection Agency issued a proposed rule that would reduce emissions of toxic air pollutants from new and existing industrial, commercial, and institutional boilers and process heaters at major source facilities.

Domtar is currently reviewing the potential impact of the proposed rule and although an estimated cost has yet to be determined, the Company believes that the proposed rule could have a significant financial impact on our U.S. pulp and paper mills.

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

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	(d) Maximum Dollar Value of Shares that May Yet be Purchased under the Plans or Programs ⁽¹⁾ (in 000s)
April 1 through April 30, 2010				\$ 150,000
May 1 through May 31, 2010	45,000	\$ 62.03	45,000	\$ 147,209
June 1 through June 30, 2010	295,130	\$ 54.84	295,130	\$ 131,023
	340,130	\$ 55.79	340,130	\$ 131,023

- (1) In the second quarter of 2010, Domtar's Board of Directors authorized a stock repurchase program of up to \$150 million of Domtar Corporation's common stock. The authorization does not have a specific expiration date.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

Not applicable.

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

Not applicable.

Table of Contents

ITEM 6. EXHIBITS

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

Table of Contents

Signature

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

Date: August 6, 2010

DOMTAR CORPORATION

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

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

60