DOMTAR INC /CANADA
Form 40-F/A
March 22, 2007

U.S. Securities and Exchange Commission
Washington, D.C. 20549
Form 40-F/A

o REGISTRATION STATEMENT PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended December 31, 2006 Commission File Number 9682

Domtar Inc.

(Exact name of Registrant as specified in its charter)
Not Applicable

(Translation of Registrant s name into English (if applicable)
Canada

(Province or other jurisdiction of incorporation or organization)
2621

(Primary Standard Industrial Classification Code-Number (if applicable))
Not applicable

(I.R.S. Employer Identification Number (if applicable))
395 de Maisonneuve Blvd. West, Montreal, Quebec, Canada H3A 1L6 (514) 848-5400

(Address and telephone number of Registrant s principal executive offices)
CT Corporation System, 111 Eighth Avenue, New York, N.Y. 10011, (212) 664-1666

(Name, address (including zip code) and telephone number (including area code) of agent for service in the United States)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Name of each exchange on which registered
Common Shares no par value	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act.
Not Applicable

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.
8.75% Notes due 2006, 7.875% Notes due 2011, 5.375% Notes due 2013,
7.125% Notes due 2015 and 9 1/2% Debentures due 2016

(Title of Class)

For annual reports, indicate by check mark the information filed with this Form:

o Annual Information form þ Audited annual financial statements

[cover continued on next page]

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

Common Shares 231,576,702 shares

Indicate by check mark whether the Registrant by filing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the Exchange Act). If Yes is marked, indicate the file number assigned to the Registrant in connection with such Rule.

Yes o 82-__________ No þ

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the last 90 days.

Yes þ No o

FORWARD-LOOKING STATEMENTS

This annual report on Form 40-F/A may contain forward-looking statements relating to trends in, or representing management s beliefs about, Domtar 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 , may , will , should and similar expressions. Th 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 such as, but not limited to, general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign currency exchange rates, the ability to integrate acquired businesses into existing operations, the ability to realize anticipated cost savings, the performance of manufacturing operations, and other factors referenced herein and in Domtar s continuous disclosure filings. These factors should be considered carefully and undue reliance should not be placed on the forward-looking statements. Although the forward-looking statements contained in this annual report on Form 40-F/A are based upon what management believes to be reasonable estimates and assumptions, Domtar cannot ensure that actual results will not be materially different from those expressed or implied by these forward-looking statements. Domtar assumes no obligation to update or revise these forward-looking statements to reflect new events or circumstances. These risks, uncertainties and other factors include, among other things, those discussed under Risk Factors as well as those discussed elsewhere in this annual report on Form 40-F/A.

Form 40-F/A

Domtar Inc.

March 21, 2007

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Management s
Discussion and Analysis
MONTREAL, QUEBEC, FEBRUARY 22, 2007

Management s Discussion and Analysis (MD&A) relates to the financial condition and results of Domtar s operations. Throughout this MD&A, unless otherwise specified, Domtar, we, us and our refer to Domtar Inc., its subsidiaries, a well as its joint ventures, and the Corporation refers to Domtar Inc. and its consolidated subsidiaries, excluding its interest in joint ventures. Domtar s common shares are listed on the Toronto and New York stock exchanges. Except where otherwise indicated, all financial information reflected herein is determined on the basis of Canadian generally accepted accounting principles (GAAP). This MD&A should be read in conjunction with Domtar s audited consolidated financial statements and notes thereto.

In accordance with industry practice, in this MD&A, the term ton or the symbol ST refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tons, and the term tonne or the symbol MT refers to a metric ton. In this MD&A, unless otherwise indicated, all dollar amounts are expressed in Canadian dollars, and the term dollars and the symbols $ and CAN$ refer to Canadian dollars. The term U.S. dollars and the symbol US$ refer to United States dollars and the term U.S. refers to the United States.

FORWARD-LOOKING STATEMENTS

This MD&A may contain forward-looking statements relating to trends in, or representing management s beliefs about, Domtar 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, a target, plan, continue, estimate, project, may, will, should and similar expressions. These statements ref 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 s results of operations or financial condition. These factors include, but are not limited to:

- the effect of general economic conditions, particularly in Canada and the U.S.;
- market demand for Domtar s products, which may be tied to the relative strength of various Canadian and/or U.S. business segments;
- product selling prices;
- energy prices;
- raw material prices;
- chemical prices;
- performance of Domtar s manufacturing operations including unexpected maintenance requirements;
- the ability to realize anticipated cost savings;
- the ability to integrate acquired businesses into existing operations;
- the level of competition from domestic and foreign producers;

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

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

transportation costs;

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

legal proceedings;

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

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

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

performance of pension fund investments and related derivatives; and

the other factors described under Risks and Uncertainties.

These factors should be considered carefully and undue reliance should not be placed on the forward-looking statements, which speak only as of the date made, when evaluating the information presented in this document. Unless specifically required by law, Domtar assumes no obligation to update or revise these forward-looking statements to reflect new events or circumstances.

2006 OVERVIEW

Our 2006 results reflected a significant improvement when compared to 2005. We benefited from higher average selling prices for paper and pulp, higher shipments for all of our major products except for wood (excluding the impact of mills that were indefinitely and permanently closed) and overall lower costs partially resulting from the realization of savings stemming from restructuring initiatives throughout our business segments. Other factors that contributed to our strengthened financial position were the refund of softwood duties, amounting to $178 million plus interest of $22 million (total of $164 million net of a special charge by the Canadian Government of $36 million), the realization of a gain of $237 million (net of applicable taxes of $62 million) on the sale of our 50% interest in Norampac, the recognition of investment tax credits related to research and development expenditures from prior years and the settlement of a sales contract dispute resulting in a payment to us of $14 million. These factors were partially offset by the strengthening of the Canadian dollar and lower average selling prices and shipments for wood products due to the continuing difficult conditions prevailing in the wood sector.

As at March 31, 2006, our Cornwall pulp and paper mill and Ottawa paper mill were permanently shut down, and as at June 30, 2006, our Vancouver paper mill and Grand-Remous and Malartic sawmills were also permanently shut down.

PROPOSED COMBINATION

In August 2006, we signed a definitive agreement to combine with Weyerhaeuser s fine paper business and related assets. Under the terms of the transaction, Weyerhaeuser s fine paper business, consisting of 10 primary pulp and paper mills (seven in the United States and three in Canada), converting, forming and warehousing facilities, sales offices, two sawmills and logging and forest management operations will be transferred into a newly formed company for stock and a cash payment of US$1.35 billion to be provided by the new company through borrowings under a temporary credit facility. Weyerhaeuser intends to distribute the shares of the new company to its shareholders through an exchange offer. Domtar will combine with the newly formed company to create Domtar Corporation. The combination is subject to approvals by: the shareholders of Domtar by a special resolution; appropriate regulatory and other authorities (all of which have been obtained); as well as customary closing conditions. The transaction will be submitted to our shareholders at a special meeting to be held on February 26, 2007 and is expected to close in March 2007. As a result of this transaction, Domtar will become an indirect subsidiary of the Domtar Corporation, a Delaware corporation.

DISCONTINUED OPERATIONS

Effective in the second quarter of 2006, as a result of the permanent closure of our Vancouver paper mill, the financial information pertaining to our Vancouver paper mill was no longer included in our Papers business but presented as a discontinued operation and as assets held for sale. Accordingly, the statement of consolidated earnings and consolidated cash flows for prior periods have been restated to reflect this presentation. Effective December 29, 2006, the financial information pertaining to Norampac is disclosed as a discontinued operation. Accordingly, the statement of consolidated earnings and consolidated cash flows for 2006 and prior periods have been restated to reflect this presentation. In accordance with GAAP, due to the fact that we continue to sell certain products formerly produced at the Cornwall and Ottawa paper mills, those operations remain in our continuing operations.

On December 29, 2006, Domtar sold its packaging segment, which consisted of a 50% interest in Norampac, to Cascades Inc. for a total cash consideration of $560 million, resulting in a gain of $237 million (net of applicable taxes of $62 million). As a result of this transaction, Domtar reduced its net debt level by $560 million compared to its third quarter of 2006, improving its balance sheet and liquidity position.

Norampac, our former joint venture in packaging, has 26 corrugated packaging plants strategically located across Canada and the United States. Norampac s eight containerboard mills, having a combined annual capacity of approximately 1.45 million tons, directly or indirectly supplied essentially all the containerboard requirements of the corrugated packaging plants. In accordance with GAAP, we accounted for our 50% interest in Norampac, up to the date of the sale, using the proportionate consolidation method.

FINANCIAL RESULTS OF DISCONTINUED OPERATIONS

EARNINGS (LOSS) FROM DISCONTINUED OPERATIONS *(In millions of Canadian dollars)*	**2006**	2005
Gain on sale of Norampac (net of applicable taxes)	**237**	
Net earnings of Norampac	**37**	3
Net loss of Vancouver paper mill	**(9)**	(81)
Earnings (loss) from discontinued operations	**265**	(78)

Our 50% interest in Norampac s net earnings from January 1, 2006 to December 29, 2006 amounted to $274 million in 2006, including a gain of $237 million (net of applicable taxes) on the sale of our interest, compared to net earnings of $3 million in 2005. The $34 million increase in net earnings, excluding the $237 million net gain on the sale, was mainly due to higher average selling prices for containerboard and corrugated containers, partially offset by the negative impact of a stronger Canadian dollar and lower shipments for containerboard and corrugated containers.

Net loss from our Vancouver paper mill amounted to $9 million in 2006, an improvement of $72 million compared to a net loss of $81 million in 2005. The improvement in the results was mainly attributable to the $89 million decrease in restructuring costs ($60 million net of applicable taxes) in 2006 compared to 2005 and the closure of the mill in June 2006.

See also Note 4 to the 2006 audited consolidated financial statements.

OUR BUSINESS

Domtar s reporting segments correspond to the following business activities: Papers, Paper Merchants and Wood.

PAPERS

We are the third largest integrated manufacturer and marketer of uncoated freesheet paper in North America. We operate four pulp and paper facilities in Canada (reflecting the permanent closures of the Cornwall pulp and paper mill and Ottawa paper mill in the first quarter of 2006 and the permanent closure of the Vancouver paper mill in the second quarter of 2006) and five in the United States, with an annual paper production capacity of approximately 2.3 million tons, complemented by strategically located warehouses and sales offices. Approximately 65% of our paper production capacity is located in the United States, and approximately 81% of our pulp and paper sales are made to customers in the United States. Uncoated and coated freesheet papers are used for business, commercial printing and publication, and technical and specialty applications. The chart below illustrates the principal paper products we produce and our annual paper production capacity.

* The allocation of production capacity may vary from period to period in order to take advantage of market conditions. We permanently closed the Cornwall pulp and paper mill and Ottawa paper mill in the first quarter of 2006, and the Vancouver paper mill in the second quarter of 2006. These permanent closures, impacting 450,000 tons of paper, have been assumed to be effective as at January 1, 2006 and have been reflected in the above capacity.

We sell paper primarily through a large network of owned and independent merchants that distribute our paper products throughout North America. We also sell our products to a variety of customers, including business offices, office equipment manufacturers, retail outlets, commercial printers, publishers and converters. In addition, we sell pulp in excess of our own internal requirements. We also purchase pulp to optimize paper production and reduce freight costs. In 2006, our net market pulp position (the amount of pulp produced in excess of our internal requirements) was approximately 563,000 tonnes.

Our Papers business is our most important segment, representing 64% of consolidated sales in 2006, or 70% when including sales of Domtar paper through our own Paper Merchants business.

PAPER MERCHANTS

Our Paper Merchants business comprises the purchasing, warehousing, sale and distribution of various products made by Domtar and other manufacturers. These products include business and printing papers and certain industrial products. Domtar-owned paper merchants operate in the United States and Canada under a single banner and umbrella name, the Domtar Distribution Group, which is the fifth largest paper merchant organization in North America. Ris Paper operates throughout the Northeast, Mid-Atlantic and Midwest areas from 20 locations in the United States, including 16 distribution centers. The Canadian business operates as Buntin Reid in three locations in Ontario; JBR/La

Maison du Papier in two locations in Quebec; and The Paper House from two locations in Atlantic Canada. Our Paper Merchants business represented 26% of consolidated sales in 2006, or 20% when excluding sales of Domtar paper.

WOOD

Our Wood business comprises the manufacturing, marketing and distribution of lumber and wood-based value-added products, and the management of forest resources. We operate eight sawmills (four in Quebec, following the permanent closure of the Grand-Remous and Malartic sawmills in the second quarter of 2006, and four in Ontario) and one remanufacturing facility (in Quebec), for an annual capacity of approximately 1.1 billion board feet of lumber. We also have an interest in two joint ventures and investments in two businesses, which all produce wood products. We seek to optimize 17 million acres of forestland directly licensed or owned by the Corporation in Canada and the United States through efficient management and the application of certified sustainable forest management practices such that a continuous supply of wood is available for future needs. Our Wood business represented 10% of consolidated sales in 2006. As at December 31, 2006, we have four sawmills and one remanufacturing facility in operation, for an annual capacity of approximately 460 million board feet of lumber.

SUMMARY OF FINANCIAL RESULTS

FINANCIAL HIGHLIGHTS *Years ended December 31* *(In millions of Canadian dollars, unless otherwise noted)*	**2006**	2005	2004
Sales	**3,989**	4,247	4,403
Operating profit (loss) from continuing operations [1]	**237**	(349)	23
Excluding specified items[2]	**139**	23	111
Earnings (loss) from continuing operations	**63**	(310)	(63)
Excluding specified items[2]	**(7)**	(51)	(4)
Earnings (loss) from continuing operations per share (in dollars):			
Basic	**0.27**	(1.36)	(0.28)
Net Earnings (loss)	**328**	(388)	(42)
Net earnings (loss) per share (in dollars):			
Basic	**1.42**	(1.69)	(0.19)
Diluted	**1.42**	(1.69)	(0.19)
Operating profit (loss) from continuing operations, excluding specified items, per segment[2]:			
Papers	**140**	(51)	21
Paper Merchants	**13**	16	21
Wood	**(28)**	51	56
Corporate	**14**	7	13
Total	**139**	23	111
Average exchange rates	CAN$ **1.134**	1.211	1.301
	US $ **0.882**	0.826	0.769
Dividends per share (declared) (in dollars):			
Series A Preferred Shares	**2.25**	2.25	2.25
Series B Preferred Shares	**1.02**	0.78	0.73
Common shares		0.18	0.24
Total assets	**4,955**	5,192	5,681
Total long-term debt, including current portion	**1,891**	2,259	2,034

[1] Operating profit (loss) from continuing operations is a non-GAAP

measure that is determined by deducting cost of sales, selling, general and administrative expenses (SG&A), amortization expense and closure and restructuring costs from sales. We focus on operating profit (loss) from continuing operations as this measure enables us to compare our results between periods without regard to debt service or income taxes. As such, we believe it would be useful for investors and other users to be aware of this measure so they can better assess our performance. Our operating profit (loss) from continuing operations measure has no standardized meaning prescribed by GAAP and is not necessarily comparable to similar measures presented by

other companies and therefore should not be considered in isolation.

[2] See Specified items affecting results and non-GAAP measures.

SPECIFIED ITEMS AFFECTING RESULTS AND NON-GAAP MEASURES

Our operating results include specified items that, in our view, do not typify normal operating activities, thus affecting the comparability of our results from period to period. To measure our performance and that of our business segments from period to period without regard to variations caused by these specified items, we focus on certain measures excluding specified items. These financial measures excluding specified items are non-GAAP measures. We define specified items as items such as the impacts of impairment of assets, facility or machine closures, changes in income tax legislation, debt restructuring, unrealized mark-to-market gains or losses on hedging contracts not considered as hedges for accounting purposes, foreign exchange impact on long-term debt translation and other items that, in our view, do not typify normal operating activities.

Our Operating profit (loss) from continuing operations is a non-GAAP financial measure that is presented as a line item sub total on the face of our GAAP statement of earnings. This non-GAAP measure is also used by management, as well as investors, to evaluate operations. Management believes that Operating profit (loss) from continuing operations, as presented, represents a useful means of assessing the performance of the Company s ongoing operating activities, as it reflects the Company s earnings trends without showing the impact of certain charges.

We believe that it is useful for investors and other users to be aware of the specified items that positively or adversely impacted our GAAP results, and that these non-GAAP measures provide investors and other users with a measure of performance to compare our results between periods without regard to these specified items.

Management uses both GAAP and non-GAAP measures to evaluate results of operations and believes that investors and other readers should be aware of both measures in order to more meaningfully evaluate operations. Some of the key users of our financial information, including analysts and creditors, request that we make these measures publicly available.

The use of Operating profit (loss) from continuing operations has certain material limitations because it excludes the recurring expenditures of financing expenses and income taxes. Financing expenses is a necessary component of our expenses because we borrow money to finance our working capital and capital expenditures. Income tax expense is also a necessary component of our expenses because we are required to pay cash income taxes. Management compensates for these limitations to the use of Operating profit (loss) from continuing operations by using it as only a supplementary measure of profitability.

We believe that the impact of the key drivers of our business i.e. price, volume and foreign exchange, on our results are more readily understandable when we separate out the identified specified items. The specified items are then separately identifiable and discussed in detail so that the impact of those items on our results may be understood. We believe this gives the reader an easy to follow format where specified items are brought to the forefront immediately allowing the reader to focus on these points separately.

Measures excluding specified items have no standardized meaning prescribed by GAAP and are not necessarily comparable to similar measures presented by other companies, and therefore should not be considered in isolation. It is important for readers to understand that certain items may be presented in different lines on the financial statements thereby leading to different measures for different companies. We compensate for this limitation by clearly identifying all items included in or excluded from our non-GAAP measures and explaining the items removed or added back to the most comparable GAAP items. The following tables reconcile these measures excluding specified items to their closest GAAP financial measures.

SPECIFIED ITEMS *Years ended December 31* *(In millions of Canadian dollars)*	**2006**		2005		2004	
	OPERATING PROFIT FROM CONTINUING OPERATIONS	**EARNINGS (LOSS) FROM CONTINUING OPERATIONS**	OPERATING PROFIT (LOSS) FROM CONTINUING OPERATIONS	LOSS FROM CONTINUING OPERATIONS	OPERATING PROFIT FROM CONTINUING OPERATIONS	LOSS FROM CONTINUING OPERATIONS
As per GAAP*	**237**	**63**	(349)	(310)	23	(63)
Specified items						
Sales of property, plant and equipment (i)	**(10)**	**(6)**	(4)	(3)	(33)	(21)
Closure and restructuring costs (ii)	**35**	**22**	317	209	49	34
Unrealized mark-to-market gains or losses (iii)	**4**	**3**	(5)	(3)	3	5
Foreign exchange gains or losses on long-term debt (iv)				(3)		(5)
Income tax legislation changes (v)		**(2)**		7		
Legal settlement (vi)	**(7)**	**(7)**	13	13		
Refinancing costs (vii)				5		
Write-down of investments (viii)	**5**	**3**				
Insurance recoveries (ix)	**(3)**	**(2)**	(3)	(2)		
Duties (x)	**(147)**	**(98)**	54	36	69	46
Transaction costs (xi)	**25**	**17**				
	(98)	**(70)**	372	259	88	59
Excluding specified items	**139**	**(7)**	23	(51)	111	(4)

* Except for operating profit (loss) from continuing operations, which is a non-GAAP measure.

SPECIFIED ITEMS *Three months ended December 31* *(In millions of Canadian dollars)*	**2006**		2005		2004	
	OPERATING PROFIT FROM CONTINUING OPERATIONS	**EARNINGS (LOSS) FROM CONTINUING OPERATIONS**	OPERATING (LOSS) FROM CONTINUING OPERATIONS	LOSS FROM CONTINUING OPERATIONS	OPERATING PROFIT (LOSS) FROM CONTINUING OPERATIONS	LOSS FROM CONTINUING OPERATIONS

As per GAAP*	**178**	**91**	(366)	(271)	(23)	(36)
Specified items						
Sales of property, plant and equipment (i)	**(10)**	**(6)**			(29)	(17)
Closure and restructuring costs (ii)	**5**	**3**	300	198	40	27
Unrealized mark-to-market gains or losses (iii)	**3**	**2**			3	2
Foreign exchange gains or losses on long-term debt (iv)						(3)
Income tax legislation changes (v)				7		
Legal settlement (vi)			13	13		
Write-down of investments (viii)	**5**	3				
Insurance recoveries (ix)	**(3)**	(2)				
Duties (x)	**(164)**	(110)	11	7	15	10
Transaction costs (xi)	**25**	17				
	(139)	**(93)**	324	225	29	19
Excluding specified items	**39**	**(2)**	(42)	(46)	6	(17)

* Except for operating profit (loss) from continuing operations, which is a non-GAAP measure.

(i) Our results reflect gains on sales of property, plant and equipment. These gains are presented under Net gains on disposals of property, plant and equipment in the consolidated financial statements.

(ii) Our results reflect closure and restructuring charges. These charges are presented under Closure and restructuring costs in the consolidated financial statements. See Closure and restructuring costs for further information.

(iii) Our results include unrealized mark-to-market gains or losses on commodity swap contracts and foreign exchange contracts not considered as hedges for accounting purposes. Such gains or losses are presented under Selling, general and administrative expenses in the consolidated financial statements.

(iv) Our results include foreign exchange gains or losses on the translation of a portion of our long-term debt. Such gains or losses are presented under Financing expenses in the consolidated financial statements.

(v) Our results include charges related to modifications to the income tax legislation. These charges are presented under Income tax expense (recovery) in the consolidated financial statements.

(vi) Our results include charges (revenues) related to a legal settlement. These charges (revenues) are presented under Selling, general and administrative expenses in the consolidated financial statements.

(vii) Our results include refinancing expenses. These refinancing expenses are presented under Financing expenses in the consolidated financial statements.

(viii) Our results include charges related to write downs of investments. These charges are presented under Selling, general and administrative expenses in the consolidated financial statements.

(ix) Our results include insurance recoveries. These recoveries are presented under Selling, general and administrative expenses in the consolidated financial statements.

(x) Our results include charges or revenues related to countervailing and antidumping duties. These revenues are presented under Antidumping and countervailing duties refund and charges are presented under Cost of sales in the consolidated financial statements.

(xi) Our results include costs related to our pending transaction with Weyerhaeuser. These costs are presented under Selling, general and administrative expenses in the consolidated financial statements.

2006 VS 2005 ANNUAL OVERVIEW

SALES OF $4 BILLION

Sales in 2006 amounted to $3,989 million, a decrease of $258 million or 6% from sales of $4,247 million in 2005. This decrease was mainly attributable to the permanent closure of the Cornwall and Ottawa paper mills effective at the end of the first quarter of 2006 and the indefinite shut down of the Lebel-sur-Quévillon pulp mill for the entire year of 2006, the negative impact of a 7% rise in the year over year average value of the Canadian dollar relative to the U.S. dollar (from $0.826 to $0.882) and lower average selling prices and shipments for wood products. These factors were partially offset by higher average selling prices for all of our major products except for wood, higher shipments for pulp and paper (excluding the impact of mills that were indefinitely and permanently closed) and the settlement in July 2006 of a sales contract dispute that resulted in a payment to us of $14 million.

OPERATING PROFIT FROM CONTINUING OPERATIONS OF $237 MILLION

Cost of sales decreased by $328 million or 9% in 2006 compared to 2005 mainly due to the permanent closure of the Cornwall and Ottawa paper mills, effective at the end of the first quarter of 2006 and the indefinite shut down of the Lebel-sur-Quévillon pulp mill. Other factors causing a decrease in cost of sales included the positive impact of a stronger Canadian dollar on our U.S. dollar denominated expenses, lower production and shipments for wood products, lower cash deposits for countervailing and antidumping duties due to the decrease in duties rate and prices, the cessation of duties collected by the U.S as of October 12, 2006, higher investment tax credits related to research and development expenditures from prior years, lower costs for purchased wood fiber and chemicals, as well as the realization of savings stemming from restructuring activities. These factors were partially offset by higher shipments for pulp and paper, and higher energy and freight costs (excluding the impact of mills that were indefinitely and permanently closed).

Selling, general and administrative (SG&A) expenses decreased by $13 million or 6% in 2006 compared to 2005. SG&A in 2006 included transaction costs of $25 million relating to our pending transaction with Weyerhaeuser s fine paper business, unrealized mark-to-market losses on financial instruments of $4 million and revenue of $7 million related to a legal settlement, while SG&A in 2005 included unrealized mark-to-market gains of $5 million, a charge of $13 million related to a legal settlement with regards to an investigation by the Canadian Competition Bureau and insurance recoveries of $3 million. When excluding these items, SG&A decreased by $30 million or 13% compared to 2005. This decrease was mainly attributable to the realization of savings stemming from restructuring activities and the Ontario government s retroactive reduction in Crown stumpage fees related to 2005 and 2006, partially offset by higher pension expenses.

Operating profit from continuing operations in 2006 amounted to $237 million compared to an operating loss from continuing operations of $349 million in 2005. Excluding specified items, operating profit from continuing operations totaled $139 million in 2006 compared to an operating profit from continuing operations of $23 million in 2005. The $116 million increase in operating profit from continuing operations excluding specified items was largely attributable to higher average selling prices for all of our major products except for wood, higher shipments for pulp and paper (excluding the impact of mills that were indefinitely and permanently closed), higher investment tax credits related to research and development expenditures from prior years, the settlement of a sales contract dispute, as well as the

realization of savings stemming from restructuring activities. These factors were partially offset by the negative impact of a stronger Canadian dollar (including the effect of our hedging program), lower average selling prices and shipments for wood products and higher energy and freight costs (excluding the impact of mills and sawmills that were permanently or indefinitely closed).

VARIANCE ANALYSIS - 2006 VS 2005
(In millions of Canadian dollars)

2005 operating profit from continuing operations, excluding specified items	**23**
Selling prices	142
Foreign exchange (net of hedging programs)	(70)
Shipments and mix	1
Other costs, including savings from mill closures	43
2006 operating profit from continuing operations, excluding specified items	**139**

SPECIFIC COST REDUCTION INITIATIVES

Since 2004, the Corporation has made an ongoing commitment to adjust production to meet its customers needs, as well as maintain operational flexibility and a competitive manufacturing base. These efforts have mainly impacted our Papers and Wood segments and have resulted in workforce reductions throughout the organization.

In 2004, we announced several initiatives aimed at achieving a run-rate of $100 million in annual cost reductions by the end of 2005. As at December 31, 2005, we had achieved our goal to deliver $100 million of annualized savings stemming from these initiatives.

In November 2005, still faced with a number of economic conditions that adversely impacted our business, such as higher energy prices and the rapid rise of the Canadian dollar, we announced a series of additional targeted measures aimed at returning the Corporation to profitability. The measures included the following initiatives:

- The permanent closure of our Cornwall pulp and paper mill, effective at the end of the first quarter of 2006, which eliminated approximately 910 permanent positions (including the 390 positions already affected by the indefinite shut down of the pulp mill, paper machine and sheeter announced in late 2004). This resulted in the permanent curtailment of 265,000 tons of uncoated and coated printing grades, as well as 145,000 tonnes of pulp (including 85,000 tons of paper and 145,000 tonnes of pulp impacted by the indefinite shut down announced in late 2004);

- The permanent closure of our Ottawa mill, effective at the end of the first quarter of 2006, which eliminated approximately 185 permanent positions and resulted in the permanent curtailment of 65,000 tons of paper;

- The permanent closure of our Vancouver coated paper mill, effective at the end of the second quarter of 2006, which eliminated approximately 285 permanent positions and resulted in the permanent curtailment of 120,000 tons of coated paper;

- The permanent closure of our Grand-Remous and Malartic sawmills, effective in the second quarter of 2006, which eliminated approximately 200 permanent positions;

- Further measures to reduce costs, as follows:
  - o Reducing SG&A expenses by permanently eliminating approximately 100 corporate and divisional permanent positions, as well as other SG&A expenses;
  - o Implementing further cost reductions at the mill level by eliminating approximately 200 operational positions;
  - o Consolidating North American administrative offices in Montreal and Cincinnati.

As at December 31, 2006, we had implemented all the announced measures.

CLOSURE AND RESTRUCTURING COSTS

Closure and restructuring costs for the fourth quarter of 2006 compared to the fourth quarter of 2005, as well as for the year 2006 compared to 2005, were as follows:

		Three months ended December 31		*Years ended December 31*
(In millions of Canadian dollars)	**2006**	2005	**2006**	2005
Costs, net of reversals of provisions, related to the permanent closures of our Cornwall, and Ottawa paper mills (severance, termination, environment and pension costs, as well as $201 million for write-down of property, plant and equipment in 2005)	**2**	264	**8**	270
Costs related to the permanent closure of two sawmills at Malartic and Grand-Remous (severance, termination, environment and pension costs, as well as $23 million for the write-down of property, plant and equipment in 2005)		30	**1**	30
Costs related to specific cost reduction initiatives (severance, termination, training and outplacement costs and other)	**3**	6	**26**	17
Total closure and restructuring costs	**5**	300	**35**	317

NET EARNINGS OF $328 MILLION

Net earnings amounted to $328 million ($1.42 per common share) in 2006 compared to a net loss of $388 million ($1.69 per common share) in 2005. Excluding specified items, loss from continuing operations amounted to $7 million in 2006 compared to a loss from continuing operations of $51 million in 2005. This $44 million improvement was mainly attributable to the factors mentioned above**.**

LIQUIDITY AND CAPITAL

Cash flows provided from operating activities of continuing operations in 2006 amounted to $222 million compared to cash flows used for operating activities of continuing operations of $41 million in 2005. Net additions to property, plant and equipment amounted to $91 million in 2006 compared to $129 million in 2005. We posted positive free cash flow[1] of $131 million in 2006 compared to negative free cash flow of $170 million in 2005. This $301 million improvement mainly reflects the refund of duties collected by the U.S Government since 2002 as well as improved profitability, partially offset by working capital requirements due to the decrease in receivables securitized in the amount of $140 million (US$120 million).

Our total long-term debt decreased by $368 million, due to the disposal of our 50% interest in Norampac and the corresponding deconsolidation of its non-recourse debt, the debt repayments made on our revolving credit facility resulting from the duties refund and better cash flow from operations. Our net debt-to-total capitalization ratio[2] as at December 31, 2006 stood at 40.2% compared to 57.7% as at December 31, 2005.

Q4 2006 VS Q4 2005 QUARTERLY OVERVIEW

SALES OF $939 MILLION

Sales in the fourth quarter of 2006 amounted to $939 million, a decrease of $51 million or 5% from sales of $990 million in the fourth quarter of 2005. This decrease was attributable to the permanent closures of the Cornwall and Ottawa paper mills effective at the end of the first quarter of 2006, the indefinite shut down of the Lebel-sur-Quévillon pulp mill, lower average selling prices and shipments for wood products and the negative impact

of a 3% rise in the quarter over quarter average value of the Canadian dollar relative to the U.S. dollar (from $0.852 to $0.878). These factors were partially offset by higher average selling prices for all of our major products except wood, and higher shipments for pulp.

[1] See Free Cash Flow table and definition in the Liquidity & Capital Resources section.

[2] See Net debt-to-total capitalization ratio table and definition in the Liquidity & Capital Resources section.

OPERATING PROFIT FROM CONTINUING OPERATIONS OF $178 MILLION

Cost of sales decreased by $113 million or 13% in the fourth quarter of 2006 compared to the fourth quarter of 2005. This decrease was mainly attributable to the permanent closures of the Cornwall and Ottawa paper mills effective at the end of the first quarter of 2006, the indefinite shut down of the Lebel-sur-Quévillon pulp mill, lower cash deposits for countervailing and antidumping duties due to the cessation of duties collected by the U.S. as of October 12, 2006, lower costs for purchased wood fiber, chemicals, energy and freight, lower shipments of wood products, the positive impact of a stronger Canadian dollar on our U.S. dollar denominated operating expenses and the realization of savings stemming from restructuring activities. These factors were partially offset by higher shipments for pulp.

SG&A expenses increased by $1 million or 1% in the fourth quarter of 2006 compared to the fourth quarter of 2005. SG&A in the fourth quarter of 2006 included transaction costs of $25 million relating to our pending transaction with Weyerhaeuser s fine paper business and unrealized mark-to-market losses on financial instruments of $3 million, while SG&A in the fourth quarter of 2005 included a charge of $13 million for a legal settlement with regards to an investigation by the Canadian Competition Bureau. Excluding these items, SG&A decreased by $14 million or 24% in the fourth quarter of 2006 compared to 2005. This decrease was mainly attributable to the realization of savings stemming from restructuring activities.

Operating profit from continuing operations in the fourth quarter of 2006 amounted to $178 million, or $39 million when excluding specified items, compared to an operating loss from continuing operations of $366 million, or $42 million when excluding specified items, for the fourth quarter of 2005. The $81 million improvement in operating profit from continuing operations excluding specified items was principally attributable to higher average selling prices for all of our major products except for wood, lower costs for purchased wood fiber, chemicals, energy and freight, higher shipments for pulp and the realization of savings stemming from restructuring activities. These factors were partially offset by the negative impact of a stronger Canadian dollar (including the effect of our hedging program) and lower average selling prices and shipments for wood products.

NET EARNINGS OF $323 MILLION

Net earnings amounted to $323 million ($1.40 per common share) in the fourth quarter of 2006 compared to a net loss of $348 million ($1.51 per common share) in the fourth quarter of 2005. Excluding specified items, loss from continuing operations amounted to $2 million in the fourth quarter of 2006 compared to a loss from continuing operations of $46 million in the fourth quarter of 2005. This $44 million improvement was mainly attributable to the factors mentioned above.

PAPERS

SELECTED INFORMATION *Years ended December 31* *(In millions of Canadian dollars, unless otherwise noted)*	**2006**	2005
Sales		
Total sales	**2,796**	2,900
Intersegment sales to Paper Merchants	**(269)**	(273)
	2,527	2,627
Operating profit (loss) from continuing operations	**121**	(329)
Sales of property, plant and equipment[1]	**(10)**	(4)
Closure and restructuring costs[1]	**34**	287
Unrealized mark-to-market gains or losses [1]	**1**	(5)
Legal settlement [1]	**(6)**	
Operating profit (loss) from continuing operations, excluding specified items	**140**	(51)
Shipments		
Paper (in thousands of ST)	**2,273**	2,432
Pulp (in thousands of ADMT)	**631**	574
Paper shipments by product offering (%):		
Copy and offset grades	**61**	56
Uncoated commercial printing & publication and premium imaging grades	**14**	19
Coated commercial printing & publication grades	**7**	9
Technical and specialty grades	**18**	16
Total	**100**	100
Benchmark prices[2]:		
Copy 20 lb sheets (US$/ton)	**902**	822
Offset 50 lb rolls (US$/ton)	**823**	726
Coated publication, no. 3, 60 lb rolls (US$/ton)	**924**	902
Pulp NBSK U.S. market (US$/ADMT)	**722**	647
Pulp NBHK Japan market[3] (US$/ADMT)	**592**	526

1 See Specified items affecting results and non-GAAP measures.

2 Source: Pulp & Paper Week. As such, these prices do not necessarily

reflect our transaction prices.

[3] Based on Pulp and Paper Week s Southern Bleached Hardwood Kraft pulp prices for Japan, increased by an average differential of US$15/ADMT between Northern and Southern Bleached Hardwood Kraft pulp prices.

SALES AND OPERATING PROFIT FROM CONTINUING OPERATIONS

Sales in our Papers business amounted to $2,527 million in 2006, a decrease of $100 million or 4% from sales of $2,627 million in 2005. This decrease in sales was mainly attributable to the closure of the Cornwall and Ottawa paper mills effective at the end of the first quarter of 2006, the indefinite shut down of Lebel-sur-Quévillon pulp mill and the negative impact of a 7% rise in the year-over-year average value of the Canadian dollar. These factors were partially offset by higher average selling prices of pulp and paper, the settlement of a sales contract dispute that resulted in a payment to us of $14 million and higher shipments of pulp and paper (excluding the impact of mills that were indefinitely and permanently closed).

Operating profit from continuing operations in our Papers business totaled $121 million in 2006 (or $140 million when excluding specified items) compared to an operating loss from continuing operations of $329 million (or $51 million when excluding specified items) in 2005. Excluding specified items, the $191 million improvement in operating profit from continuing operations is largely the result of higher average selling prices for paper and pulp, the realization of savings stemming from restructuring activities, the settlement of a sales contract dispute resulting in a payment to Domtar of $14 million, higher shipments of pulp and paper (excluding the impact of mills that were indefinitely and permanently closed), as well as recognition of investment tax credits related to research and development expenditures from prior years. These factors were partially offset by the negative impact of a stronger Canadian dollar and higher costs for purchased fiber, chemicals and energy as well as freight.

PRICING ENVIRONMENT

In our Papers business, our average transaction prices, denominated in U.S. dollars, increased in 2006 compared to 2005. Within our Canadian operations, although the rise of the Canadian dollar negatively impacted our Canadian dollar denominated prices, which are derived from U.S. dollar denominated prices, overall our average transaction prices denominated in Canadian dollars increased in 2006 compared to 2005.

Our average transaction prices, denominated in U.S. dollars, for our basket of copy and offset grades, increased on average by approximately 11% in 2006 compared to 2005. Within this basket, our average transaction prices for copy 20 lb sheets and offset 50 lb rolls, which represented approximately 35% of our paper sales in 2006, were higher on average by US$97/ton and US$100/ton, respectively, in 2006 compared to 2005.

Our average transaction prices for Northern Bleached Softwood Kraft (NBSK) pulp increased by US$38/tonne and our average transaction prices for Northern Bleached Hardwood Kraft (NBHK) pulp increased by US$45/tonne in 2006 compared to 2005.

OPERATIONS

Shipments

Our paper shipments to capacity ratio was 96.0% in 2006 compared to 94.2% in 2005, largely as a result of reduced capacity following the mill closures.

Our pulp shipments increased by 57,000 tons in 2006 compared to 2005 despite the indefinite shut down of the Lebel-sur-Quévillon pulp mill in November 2005. This increase in trade shipments resulted from less internal use and more trade sales as a result of the permanent mill closures mentioned above.

Labor

A collective agreement expired in April 2004 for our Lebel-sur-Quévillon pulp mill (affecting approximately 350 employees). Negotiations have ceased as the mill is closed for an indefinite period.

In July 2006, a 5 year agreement, expiring April 30, 2010, was reached and ratified with the union at the Windsor mill (affecting approximately 760 employees).

Restructuring

In November 2005, we announced the permanent shut down of our Cornwall pulp and paper mill as well as our Ottawa paper mill, which became effective at the end of the first quarter of 2006. As a result, the book value of these mills was reduced to their net recoverable value. We also announced our intention to seek a buyer for our Vancouver paper mill. Our Vancouver paper mill was permanently closed as at the end of the second quarter of 2006. In July 2006, we reached an agreement to sell our Vancouver paper mill property for a total consideration of approximately $24 million, which represents its approximate net recoverable value. This agreement is subject to a number of closing conditions and should be completed in the first half of 2007. In September 2006, we sold our facility and land in Cornwall, for proceeds of $4 million and a corresponding gain of $1 million ($1 million net of income taxes). These closures resulted in a reduction of our production capacity of 145,000 tonnes of pulp and 450,000 tons of paper per annum and impacted approximately 1,380 positions.

Other

In November 2005, we announced the indefinite shut down of the Lebel-sur-Quévillon pulp mill due to unfavorable economic conditions. As of December 31, 2006, economic factors such as increasing wood fiber supply costs, energy and transportation costs, the strengthening of the Canadian dollar and labor costs that are not competitive, did not allow us to reopen the pulp mill and operate profitably. As a result, the Lebel-sur-Quévillon pulp mill was indefinitely

idled rather than permanently shut down. By the end of May 2006, we had to meet our obligations under

Quebec law with respect to temporary lay-offs exceeding six months. These obligations resulted in severance payments of approximately $7 million.

In July 2006, we settled a sales contract dispute that mutually resolved our differences, resulting in a payment to Domtar of approximately $14 million (US$12 million) that was received in July 2006.

In October 2006, we sold a parcel of timberlands for proceeds of $11 million (US$10 million) and a corresponding gain of $10 million (US$9 million).

During the second quarter of 2005, we sold our facility and land in Senneville, Quebec, for proceeds of $6 million and a corresponding gain of $4 million.

PAPER MERCHANTS

SELECTED INFORMATION *Years ended December 31* *(In millions of Canadian dollars)*	**2006**	2005
Sales	**1,051**	1,047
Operating profit from continuing operations	**13**	3
Legal settlement[1]		13
Operating profit from continuing operations, excluding specified items	**13**	16

[1] See Specified items affecting results and non-GAAP measures.

SALES AND OPERATING PROFIT FROM CONTINUING OPERATIONS

Our Paper Merchants business generated sales of $1,051 million in 2006, an increase of $4 million compared to 2005. This increase was attributable to higher average selling prices and higher shipments partially offset by the negative impact of a stronger Canadian dollar.

Operating profit from continuing operations amounted to $13 million in 2006 compared to $3 million in 2005. In 2005, the operating profit from continuing operations included a charge of $13 million related to a legal settlement with regards to an investigation by the Canadian Competition Bureau relating to the sales of carbonless sheet paper in Ontario and Quebec during a one-year period spanning part of 1999 and 2000. When excluding specified items, our operating profit from continuing operations amounted to $13 million (reflecting an operating margin of 1.2%) in 2006 compared to $16 million (reflecting an operating margin of 1.5%) in 2005. The $3 million decrease in operating profit from continuing operations excluding specified items was primarily due to a one time bad debt expense and the negative impact of a stronger Canadian dollar, partially offset by higher shipments.

WOOD

SELECTED INFORMATION *Years ended December 31* *(In millions of Canadian dollars, unless otherwise noted)*	**2006**	2005
Sales		
Lumber sales	**375**	521
Wood chips and other sales	**86**	176
Sub-total	**461**	697
Intersegment sales	**(50)**	(124)
	411	573
Operating profit (loss) from continuing operations	**117**	(33)
Closure and restructuring costs [1]	**1**	30
Legal settlement [1]	**(1)**	
Insurance recoveries[1]	**(3)**	
Write-down of investments[1]	**5**	
Duties[1]	**(147)**	54
Operating profit (loss) from continuing operations, excluding specified items	**(28)**	51
Shipments (millions of FBM)	**916**	1,107
Shipments by product offering (%):		
Random lengths	**38**	33
Studs	**32**	35
Value-added	**26**	27
Industrial	**4**	5
Total	**100**	100
Benchmark prices[2]:		
Lumber G.L. 2x4x8 stud (US$/MFBM)	**344**	418
Lumber G.L. 2x4 R/L no. 1 & no. 2 (US$/MFBM)	**368**	420

1 See Specified items affecting results and non-GAAP measures.

2 Source: Random Lengths. As such, these prices do not necessarily reflect our transaction prices.

SALES AND OPERATING PROFIT FROM CONTINUING OPERATIONS

Sales in our Wood business amounted to $411 million in 2006, a decrease of $162 million or 28% compared to sales of $573 million in 2005. This decrease was largely attributable to lower average selling prices and lower shipments, mainly as a result of the permanent shut down of two sawmills and the indefinite shut down of the Lebel-sur-Quévillon pulp mill in addition to four other sawmills, as well as the negative impact of a stronger Canadian dollar and the slowdown in the U.S. housing industry.

Operating profit from continuing operations in our Wood business totaled $117 million in 2006 (or a loss from continuing operations of $28 million when excluding specified items) compared to an operating loss from continuing operations of $33 million (or a profit from continuing operations of $51 million when excluding specified items) in

2005. Excluding specified items, the $79 million change in operating profit from continuing operations was mainly attributable to lower average selling prices and shipments for lumber and chips as well as the negative impact of a stronger Canadian dollar. These factors were partially mitigated by the realization of savings stemming from restructuring activities, lower freight and energy costs, mostly due to the indefinite closure of sawmills, and the $7 million refund received in the second quarter of 2006 as a result of the Ontario government s retroactive reduction in Crown stumpage fees related to 2005 and 2006.

Cash deposits of $17 million were made on our softwood lumber exports to the U.S. in 2006 compared to $54 million in 2005. Since May 22, 2002, cash deposits for countervailing and antidumping duties were made and expensed by Domtar. On April 27, 2006, the Canadian and U.S. Governments signed a term sheet which addressed the refund of duty deposits and set out a framework for the management of Canadian

softwood lumber exports to the U.S. for a seven-year period. Specific implications of the Agreement included the immediate revocation by the U.S. of the antidumping and countervailing duties orders, with retroactive effect to May 2002; the cessation of countervailing and antidumping duties collections by the U.S.; the termination of ongoing administrative reviews by the U.S.; the prohibition of any new antidumping or countervailing duties investigations in respect of softwood lumber from Canada for the duration of the Agreement and the immediate imposition by the Government of Canada of the export tax regime depending on the option selected by the region. As a result, Domtar received a refund for duties collected by the U.S. Government since 2002 and interest, amounting to $178 million plus interest of $22 million, during the fourth quarter of 2006. This refund was subject to a special charge of approximately 18% by the Canadian Government. As at December 31, 2006, Domtar recorded a provision of $36 million relating to this special charge, which was paid in January 2007.

PRICING ENVIRONMENT

Our average transaction price for Great Lakes 2x4 stud decreased by US$74/MFBM and our average transaction price for Great Lakes 2x4 random length decreased by US$52/MFBM in 2006 compared to 2005.

OPERATIONS

In January 2007, due to the difficult market conditions that have prevailed in the wood sector in recent months, including the slowdown in the U.S. housing market and the new softwood lumber agreement, we announced the indefinite closure of our White River sawmill expected to be effective in the second quarter of 2007. The closure will impact approximately 140 permanent positions.

In November 2005, due to reduced softwood fiber allocations, which have increased fiber costs in Quebec, we announced the permanent closures of our Grand-Remous and Malartic sawmills, which became effective in the second quarter of 2006. As a result, the book value of these sawmills was reduced to their net recoverable value. These closures impacted approximately 200 permanent positions. Subject to government approval, the wood fiber allocation for Grand-Remous and Malartic will be transferred to Domtar s other Quebec sawmills. This will ensure more efficient operations by going to three shifts and will offer the possibility for approximately 80 employees from the closed sawmills to obtain new positions created by an additional shift. We are currently working with a partner, in collaboration with the Quebec government, on a value-added project to use the Grand-Remous and Malartic infrastructures. In June 2006, we signed an agreement in principle with TechCana related to the sale of certain assets located at those sawmills. This agreement was originally scheduled for completion in the third quarter of 2006 and has been subsequently delayed to the second quarter of 2007. This transaction is subject to the satisfaction of a number of customary closing conditions.

In November 2005, the decision to temporarily shut down our Lebel-sur-Quévillon pulp mill due to unfavorable economic conditions caused us to indefinitely idle our adjacent sawmill. The Lebel-sur-Quévillon sawmill restarted temporarily in the second quarter of 2006 in order to process its roundwood inventory and shut down indefinitely again on October 11, 2006. Additionally, on October 11, 2006, we announced the indefinite closures of three other sawmills (two in Abitibi, Quebec, and one in Ontario). The closures, which occurred in October 2006, are primarily due to the pressure of higher timber costs and lower demand for both lumber and wood chips. These closures impacted approximately 360 permanent positions and reduced production capacity by approximately 400 million board feet of lumber.

In early 2005, we announced, in conjunction with Tembec Inc. (Tembec), the restructuring of our northeastern Ontario sawmill operations, resulting in the permanent closure of our Chapleau sawmill as of March 6, 2005. This measure impacted 67 permanent positions. This initiative arose from a review of our northeastern Ontario sawmill operations in light of prevailing challenging conditions. This initiative allowed us to add a third shift at our Elk Lake sawmill in April 2005 to process additional fiber resulting from the Chapleau closure and the resulting fiber swap with Tembec.

Throughout 2005, certain of our operations were negatively impacted by several events and market conditions. In early March 2005, a fire destroyed our planer at Elk Lake causing dressing activities to be transferred primarily to our Chapleau mill facility until the planer was rebuilt and put into operation in November 2005. Additionally, a forest fire in May 2005 negatively impacted our operations and resulted in a loss of 25,000 cubic meters of cut wood and 30,000 acres of forest. Higher wood fiber costs in Quebec and a reduction in harvest volumes further affected our

productivity.

We will continue examining opportunities to further improve the profitability of our Wood business through additional cost reductions and strategic initiatives.

Fiber supply

The Province of Quebec adopted new legislation, which became effective April 1, 2005, that reduced allowable wood-harvesting volumes by an average of 20% on public lands and 25% on territories covered by an agreement between the Government of Quebec and Cree First Nations. As a

result, the amount of fiber we were permitted to harvest annually, under our existing licenses from the Quebec government, was reduced by approximately 500,000 cubic meters to approximately 2.0 million cubic meters, reflecting a 21% reduction. Recently, the Chief forester of Quebec has proposed a further reduction of 70,000 cubic meters, or 3%, in the total softwood annual allowable cut of forests managed by Domtar. This would significantly affect the supply of fiber for our Northern Quebec softwood sawmills and market pulp operations. Resulting from the closure in November 2005 of our pulp mill at Lebel-sur-Quévillon due to unfavorable economic conditions and no alternative markets for chips produced by our sawmills, as well as the reduced allowable wood harvesting volume, our Northern Quebec softwood sawmills, including Val d Or, Matagami and Lebel-sur-Quévillon, were closed for an indefinite period of time. These sawmills closures represent a combined annual capacity of approximately 400 million board feet of lumber.

We are currently working on finding solutions such as obtaining alternate sources of fiber. The reduction in harvest volume has a corresponding increase in the unit cost of wood delivered to the sawmills. If we are unable to maintain an adequate supply of fiber to mitigate the significant cost increase and wood delivery cost, our Northern Quebec softwood sawmills and market pulp operations may not reopen and may result in permanent closures or impairment of assets.

FINANCING EXPENSES AND INCOME TAXES

FINANCING EXPENSES

In 2006, financing expenses amounted to $150 million compared to $144 million in 2005. In 2005, our financing expenses included $7 million relating to early redemption expenses arising from the refinancing of a portion of our long-term debt and $5 million relating to a foreign exchange gain on the translation of a portion of our long term debt. Excluding those two items, the $8 million increase in financing expenses was largely due to higher interest rates, which impacted interest expense related to our revolving credit as well as our securitization program, partially offset by the positive impact of a stronger Canadian dollar on our U.S. dollar interest expense.

INCOME TAXES

In 2006, our income tax expense totaled $24 million compared to an income tax recovery of $183 million in 2005. This variation is primarily due to the realization of earnings in 2006 compared to losses in 2005. To a lesser extent, this variation results from a combination of other factors, including a tax recovery adjustment of $2 million due to a decrease in statutory enacted income tax rates, $10 million following the income tax reassessment of prior years by tax authorities, the mix and level of earnings subject to different tax jurisdictions and differences in tax rates applicable to our foreign subsidiaries.

BALANCE SHEET

Since Domtar sold its 50% interest in Norampac in December 2006, the 2006 balance sheet does not contain information pertaining to Norampac, whereas the 2005 balance sheet does. In order to achieve comparability, we provided below some of the 2005 balance sheet items excluding information pertaining to our 50% interest in Norampac.

BALANCE SHEET ITEMS *(In millions of Canadian dollars)*	**2006**	2005	2005 exluding Norampac
Receivables	**305**	294	198
Inventories	**575**	715	646
Property, plant and equipment	**3,044**	3,634	3,254
Assets held for sales	**24**		
Goodwill	**6**	92	6
Other Assets	**275**	309	292
Trade and other payables	**533**	651	569
Long-term debt (including the portion due within one year)	**1,891**	2,259	2,053
Future income taxes	**285**	292	216
Other liabilities and deferred credits	**223**	331	299
Accumulated foreign currency translation adjustments	**(202)**	(205)	(200)

Our total consolidated assets were $4,955 million as at December 31, 2006 compared to $5,192 million, including Norampac, as at December 31, 2005. The following is a comparison of 2006 versus 2005 excluding Norampac. Receivables amounted to $305 million as at December 31, 2006, an increase of $107 million when compared to $198 million as at December 31, 2005. This increase is mostly due to reduced securitized receivables in the amount of $140 million and higher average selling prices, partially offset by mill closures. Inventories as at December 31, 2006 totaled $575 million, a decrease of $71 million when compared to $646 million as at December 31, 2005. This decrease is mostly attributable to lower levels of raw materials (wood inventory) due to the impact of mill closures. Property, plant and equipment as at December 31, 2006 amounted to $3,044 million compared to $3,254 million as at December 31, 2005. This $210 million decrease was mainly attributable to a greater level of amortization expense compared to capital expenditures. Other assets stood at $275 million as at December 31, 2006 compared to $292 million as at December 31, 2005. This $17 million decrease was attributable to, among other things, impairment of an investment in the wood segment and mark-to-market losses of our pulp swap financial instruments, partially offset by higher funding of our pension assets compared to pension expense.

Trade and other payables stood at $533 million as at December 31, 2006, a decrease of $36 million compared to $569 million as at December 31, 2005. This decrease is mainly attributable to the timing of payments and expenses in December 2006 versus December 2005, as well as mill closures. Long-term debt (including the portion due within one year) stood at $1,891 million as at December 31, 2006, a decrease of $162 million compared to $2,053 million as at December 31, 2005. This decrease is mainly due to debt repayments made on our revolving credit facility. Future income taxes stood at $285 million as at December 31, 2006, a $69 million increase compared to $216 million as at December 31, 2005. This increase is due to the utilization of prior years losses to reduce the taxable income in 2006. Accumulated foreign currency translation adjustments were negative $202 million as at December 31, 2006 compared to negative $200 million as at December 31, 2005. This variation reflects the net impact of a stronger Canadian dollar on the net assets of our self-sustaining U.S. subsidiaries, or $1 million, net of the impact of a stronger Canadian dollar on the long-term debt designated as a hedge of the above-mentioned net assets, or $1 million, and its corresponding income tax effect of $1 million.

LIQUIDITY AND CAPITAL RESOURCES

FREE CASH FLOW *Years ended December 31* *(In millions of Canadian dollars)*	**2006**	2005	2004
Cash flows provided from operating activities of continuing operations before changes in working capital and other items	**389**	141	207
Changes in working capital and other items	**(167)**	(182)	(121)
Cash flows provided from (used for) operating activities of continuing operations	**222**	(41)	86
Net additions to property, plant and equipment	**(91)**	(129)	(126)
Free cash flow[1]	**131**	(170)	(40)

[1] Free cash flow is a non-GAAP measure that we define as the amount by which cash flows provided from operating activities of continuing operations, as determined in accordance with GAAP, exceeds net additions to property, plant and equipment, as determined in accordance with GAAP (additions to property, plant and equipment net of proceeds from disposals of property, plant and equipment). We use free cash flow in evaluating our ability and that of our business

segments to service our debt and pay dividends to our shareholders and, as such, believe it would be useful for investors and other users to be aware of this measure so they can better assess our performance. Our free cash flow measure has no standardized meaning prescribed by GAAP and is not necessarily comparable to similar measures presented by other companies and therefore should not be considered in isolation.

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

OPERATING ACTIVITIES

Cash flows provided from operating activities of continuing operations totaled $222 million in 2006 compared to cash flows used for operating activities of continuing operations of $41 million in 2005. This $263 million improvement in cash flows generated from continuing operations mainly reflects an increase in profitability, due in large part to the duties refund, as well as decreased requirements for working capital. Change in working capital for 2006 includes an increase in receivables due to a reduction of off balance sheet securitization in the amount of $140 million (US$120 million). Our operating cash flow requirements are primarily for salaries and benefits, the purchase of wood fiber, energy and raw materials and other expenses such as property taxes.

INVESTING ACTIVITIES

Cash flows provided from investing activities of continuing operations totaled $471 million in 2006 compared to cash flows used for investing activities of continuing operations of $132 million in 2005. The $603 million improvement in cash flows provided from investing activities of continuing operations was mainly attributable to the sale of our 50% interest in Norampac for which we received a cash consideration of $560 million and to a lesser extent, fewer additions to property, plant and equipment. We intend to limit our annual capital expenditures to below 75% of

amortization. Capital expenditures required to maintain existing operations are approximately $90 million annually.

Free cash flow in 2006 was $131 million compared to negative $170 million in 2005. This improvement mainly reflects an increase in profitability offset by working capital requirements.

FINANCING ACTIVITIES

In 2006, cash flows used for financing activities of continuing operations amounted to $115 million compared to cash flows provided from financing activities of continuing operations of $188 million in 2005. This $303 million increase in cash flows used for financing activities of continuing operations is largely attributable to a repayment on our revolving credit facility resulting from better cash flow from operations, which included the refund for duties collected by the U.S. Government, lower borrowings and reduced dividend payments.

On October 27, 2005, as part of its plan to improve its free cash flow availability, Domtar announced that it was suspending its $0.24 per common share dividend. This decision resulted in annual cash savings of approximately $55 million, based on the $0.24 per common share dividend Domtar had been paying at the time of the suspension.

NET DEBT-TO-TOTAL CAPITALIZATION RATIO[1] *As at December 31* *(In millions of Canadian dollars, unless otherwise noted)*	**2006**	2005	2004
Bank indebtedness	**62**	21	22
Long-term debt (including portion due within one year)	**1,891**	2,259	2,034
Cash and cash equivalents	**(649)**	(83)	(52)
Net debt	**1,304**	2,197	2,004
Shareholders equity	**1,941**	1,609	2,046
Total capitalization	**3,245**	3,806	4,050
Net debt-to-total capitalization (%)	**40.2%**	57.7%	49.5%

1 Net debt-to-total capitalization ratio is a non-GAAP measure. We track this ratio on a regular basis in order to assess our debt position. We therefore believe it would be useful for investors and other users to be aware of this measure so they can better assess our performance. Net debt-to-total capitalization ratio has no standardized meaning prescribed by GAAP and is not necessarily comparable to similar measures

presented by other companies and therefore should not be considered in isolation.

As at December 31, 2006, our net debt-to-total capitalization ratio was 40.2% compared to 57.7% as at December 31, 2005. Net indebtedness was $1,304 million as at December 31, 2006 compared to $2,197 million, including Norampac, as at December 31, 2005. The $893 million decrease in net indebtedness was largely due to an increase in cash and cash equivalents resulting from the proceeds on sale of our 50% interest in Norampac, the corresponding deconsolidation of our 50% interest in Norampac and corresponding non-recourse debt as well as repayment on our revolving credit facilities resulting from the refund of duties.

On March 3, 2005, Domtar entered into a new five-year unsecured revolving credit facility of US$700 million. This amount was reduced to US$600 million pursuant to an amendment to this facility in November 2005. This new facility replaced the prior credit facility, which consisted of a US$500 million unsecured revolving credit facility and a US$70 million unsecured term loan that was scheduled to mature in July 2006.

Borrowings under this new unsecured revolving credit facility bear interest at a rate based on the Canadian dollar bankers acceptance or U.S. dollar LIBOR rate, each with an added spread that varies with our credit rating, or on the Canadian or U.S. prime rate. This credit facility also requires commitment fees that vary with our credit rating.

In connection with the November 2005 amendment, Domtar made certain changes to its credit facility, which matures in 2010, in order to improve financial flexibility. This amendment contained certain financial covenants which require Domtar, on a rolling four quarter basis, to maintain (a) a minimum EBITDA[2] to interest ratio of 1.5 : 1.0 by the end of 2006, increasing to 1.75 : 1.0 in 2007 and 2.5 : 1.0 at the beginning of 2008, excluding from the calculation most of the charges related to our restructuring plans, and (b) a minimum EBITDA[2] of $225 million in 2006, increasing to $325 million in 2007, as calculated in accordance with our credit facility which exclude from the calculation most of the charges related to our restructuring plans. There is no minimum EBITDA[2] requirement after 2007. Domtar, on a quarterly basis, is required not to exceed a maximum debt-to-total capitalization ratio of 60%, excluding from the calculation most of the impact of the restructuring plans. The amendment also included a reduction in the size of the facility from US$700 million to US$600 million, and provided for guarantees by Domtar s subsidiaries.

As at December 31, 2006, this credit facility had no drawings, US$16 million ($18 million) of letters of credit outstanding and no amounts drawn in the form of bank overdraft and included in Bank indebtedness, resulting in US$584 million ($681 million) of availability for future drawings under this facility. As of December 31, 2005, we had drawings of US$137 million ($160 million), US$18 million ($21 million) letters of credit outstanding, and US$13 million ($15 million) drawn in the form of bank overdraft and included in Bank indebtedness.

As at December 31, 2006, we had a provision of $4 million related to these letters of credit ($4 million as at December 31, 2005).

In addition, as at December 31, 2006, separate letters of credit of $3 million were outstanding. No provisions relating to these letters of credit were recorded.

Our borrowing agreements contain restrictive covenants. See the discussion above for covenants related to our unsecured bank credit facility. The indentures related to the 10% and 10.85% debentures limit the amount of dividends that may be paid and the amount of shares that may be repurchased for cancellation. These indentures also require that no new long-term debt be incurred, unless total long-term debt is less than 50% of consolidated net tangible assets, but do not restrict the incurrence of new long- term debt related to the purchase of property or the replacement

[2] EBITDA as defined in the credit agreement.

of existing long-term debt or the issuance of short-term debt. All our borrowing agreements contain restrictions on the amount of secured borrowings we can incur with other lenders.

CREDIT RATINGS

RATING AGENCY	SECURITY	RATING
Dominion Bond Rating Service	Unsecured Notes and Debentures	BB (low)
	Preferred Shares	P5 (high)
Moody s Investors Services	Unsecured Notes and Debentures	B2
Standard & Poor s	Unsecured Notes and Debentures	B+

The above ratings represent a risk assessment of our public unsecured debt securities. The rating by Dominion Bond Rating Service (DBRS) is the fifth best rating in terms of quality within ten rating gradations, with the low indicating a ranking in the lower end of this rating category. The rating by Moody s Investors Services (Moody s) is the sixth best rating in terms of quality within nine rating gradations, with the numerical modifier 2 indicating a ranking in the middle end of this rating category. The rating by Standard & Poor s (S&P) is the sixth best rating in terms of quality within ten rating gradations, with the plus indicating a ranking at the higher end of this category.

During the past year, our unsecured note rating with DBRS fell from BB (high) to BB (low) and our unsecured note rating with Moody s fell from B1 to B2. These reductions in our credit ratings impact our access to and cost of capital and financial flexibility. Further reductions in our credit ratings would have an added negative impact on our financial flexibility. The above ratings are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the above rating agencies.

Common shares

In 2006, common shares amounting to $4 million were issued, net of expenses, pursuant to our stock option and share purchase plans compared to $7 million in 2005.

As at January 31, 2007, we had 231,605,809 common shares, 67,476 Series A Preferred Shares and 1,230,000 Series B Preferred Shares issued and outstanding.

As at January 31, 2007, we had 4,321,757 common share purchase options issued and outstanding under the Executive stock option and share purchase plan.

OFF BALANCE SHEET ARRANGEMENTS

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

LEASES

On an ongoing basis, we enter into operating leases for property, plant and equipment. Minimum future rental payments under these operating leases, determined as at December 31, 2006, amounted to $87 million.

SECURITIZATIONS

The Corporation sells its trade receivables through a securitization program which expires in February 2009. The Corporation uses securitization of its receivables as a source of financing by reducing its working capital requirements. This securitization consists of the sale of receivables, or the sale of senior beneficial interest in them, to special purpose trusts managed by financial institutions for multiple sellers of receivables. The agreement normally allows the daily sale of new receivables to replace those that have been collected. It also limits the cash that can be received from the sale of the senior beneficial interest. Such sales of receivables are contingent upon annual renewals and retaining specified credit ratings. The subordinate interest retained by the Corporation is included in Receivables and will be collected only after the senior beneficial interest has been settled. The book value of the retained subordinated interests approximates fair value.

As at December 31, 2006 and December 31, 2005, the senior beneficial interest in receivables held by third parties amounted to $23 million and $163 million, respectively. The Corporation expects to continue selling receivables on an ongoing basis, given the attractive discount rates.

Should this program be discontinued either by management s decision or due to termination of the program by the provider, the Corporation s working capital and bank debt requirements would increase.

GUARANTEES

INDEMNIFICATIONS

In the normal course of business, the Corporation 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. As at December 31, 2006, the Corporation is unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provisions have been recorded. These indemnifications have not yielded significant expenses in the past.

PENSION PLANS

We have indemnified and held harmless the trustees of Domtar s 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 of Domtar or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. As at December 31, 2006, 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, the 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 the Corporation in specified circumstances, the Corporation may have had to pay up to a maximum of $120 million, an amount which is gradually declining over a 25-year period. As at December 31, 2006, the maximum amount of the purchase price adjustment was $110 million. No provision was recorded for this potential purchase price adjustment.

DEBT AGREEMENTS

Certain debt agreements require the Corporation to indemnify the parties in the event of changes in elements such as withholding tax regulations. As the nature and scope of such indemnifications are contingent on future events, none of which can be foreseen as at December 31, 2006, and the structure of such transactions makes these events unlikely, no provisions have been recorded in the consolidated financial statements.

CONTRACTUAL OBLIGATIONS
AND COMMERCIAL COMMITMENTS

In the normal course of business, we enter into certain contractual obligations and commercial commitments. The following tables provide our obligations and commitments as at December 31, 2006:

CONTRACTUAL OBLIGATIONS CONTRACT TYPE *(In millions of Canadian dollars)*	2007	2008	2009	2010	2011	THEREAFTER	TOTAL
Debentures and notes					781	1,095	1,876
Other	2		3			10	15
Long-term debt	2		3		781	1,105	1,891
Operating leases	20	17	13	11	9	17	87
Total obligations	22	17	16	11	790	1,122	1,978

COMMERCIAL OBLIGATIONS COMMITMENT TYPE *(In millions of Canadian dollars)*	2007	2008	2009	2010	2011	THEREAFTER	TOTAL
Letters of credit	18						18
Other commercial commitments*	85	34	25	9	7	6	166
Total commitments	103	34					