

Domtar CORP
Form 10-Q
August 04, 2017

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, 2017

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 001-33164

DOMTAR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

20-5901152
(I.R.S. Employer

Identification No.)

234 Kingsley Park Drive, Fort Mill, SC 29715

(Address of principal executive offices)

(zip code)

(803) 802-7500

(Registrant's telephone number)

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

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required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES NO

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a small reporting company) Small reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

At July 31, 2017, 62,654,157 shares of the issuer’s common stock were outstanding.

DOMTAR CORPORATION

FORM 10-Q

For the Quarterly Period Ended June 30, 2017

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PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS (UNAUDITED)

DOMTAR CORPORATION

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

	Three months ended June 30, 2017 (Unaudited) \$	Three months ended June 30, 2016 (Unaudited) \$	Six months ended June 30, 2017 \$	Six months ended June 30, 2016 \$
Sales	1,224	1,267	2,528	2,554
Operating expenses				
Cost of sales, excluding depreciation and amortization	968	1,013	2,043	2,063
Depreciation and amortization	79	87	159	176
Selling, general and administrative	111	104	219	207
Impairment of property, plant and equipment (NOTE 11)	—	3	—	24
Closure and restructuring costs (NOTE 11)	—	21	—	23
Other operating loss, net (NOTE 6)	2	—	1	4
	1,160	1,228	2,422	2,497
Operating income	64	39	106	57
Interest expense, net	17	15	34	32
Earnings before income taxes	47	24	72	25
Income tax expense (NOTE 7)	9	6	14	3
Net earnings	38	18	58	22
Per common share (in dollars) (NOTE 4)				
Net earnings				
Basic	0.61	0.29	0.93	0.35
Diluted	0.61	0.29	0.93	0.35
Weighted average number of common shares outstanding (millions)				
Basic	62.6	62.6	62.6	62.7
Diluted	62.7	62.7	62.7	62.8
Cash dividends per common share	0.415	0.40	0.83	0.80
Net earnings	38	18	58	22
Other comprehensive income (loss) (NOTE 12):				

Net derivative gains (losses) on cash flow hedges:

Net gains arising during the period, net of tax of

\$ (2) and \$ (2), respectively (2016 – \$ (5)

and \$ (18), respectively

2 9 2 29

Less: Reclassification adjustment for (gains) losses

included in net earnings, net of tax of nil and \$ 2,

respectively (2016 – \$ (3) and \$ (8), respectively)

(1) 5 (4) 13

Foreign currency translation adjustments

67 (30) 82 55

Change in unrecognized gains and prior service cost related to

pension and post-retirement benefit plans, net of tax of

\$ (1) and \$ (2), respectively (2016 – \$ (1) and \$ (2), respectively)

3 2 5 3

Other comprehensive income (loss)

71 (14) 85 100

Comprehensive income

109 4 143 122

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

DOMTAR CORPORATION

CONSOLIDATED BALANCE SHEETS

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

	At	
	June 30, 2017	December 31, 2016
	(Unaudited)	
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	124	125
Receivables, less allowances of \$7 and \$7	613	613
Inventories (NOTE 8)	759	759
Prepaid expenses	41	40
Income and other taxes receivable	18	31
Total current assets	1,555	1,568
Property, plant and equipment, net	2,779	2,825
Goodwill (NOTE 9)	569	550
Intangible assets, net (NOTE 10)	625	608
Other assets	139	129
Total assets	5,667	5,680
Liabilities and shareholders' equity		
Current liabilities		
Bank indebtedness	—	12
Trade and other payables	627	656
Income and other taxes payable	28	22
Long-term debt due within one year	1	63
Total current liabilities	656	753
Long-term debt	1,203	1,218
Deferred income taxes and other	677	675
Other liabilities and deferred credits	361	358
Commitments and contingencies (NOTE 14)		
Shareholders' equity (NOTE 13)		
Common stock \$0.01 par value; authorized 2,000,000,000 shares; issued:		
65,001,104 and 65,001,104 shares	1	1
Treasury stock \$0.01 par value; 2,346,947 and 2,412,267 shares	—	—
Additional paid-in capital	1,966	1,963
Retained earnings	1,217	1,211
Accumulated other comprehensive loss	(414)	(499)
Total shareholders' equity	2,770	2,676
Total liabilities and shareholders' equity	5,667	5,680

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

DOMTAR CORPORATION

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

	Issued and outstanding common shares					Accumulated other comprehensive loss	Total shareholders' equity
	(million of shares) (Unaudited)	Common stock, at par	Additional paid-in capital	Retained earnings			
	\$	\$	\$	\$	\$	\$	\$
Balance at December 31, 2016	62.6	1	1,963	1,211	(499	)	2,676
Stock-based compensation, net of tax	0.1	—	3	—	—		3
Net earnings	—	—	—	58	—		58
Net derivative losses on cash flow hedges:							
Net gains arising during the period, net of tax							
of \$(2)	—	—	—	—	2		2
Less: Reclassification adjustments for gains							
included in net earnings, net of tax of \$2	—	—	—	—	(4	)	(4
Foreign currency translation adjustments	—	—	—	—	82		82
Change in unrecognized gains and prior service cost							
related to pension and post-retirement benefit plans, net of tax of \$(2)	—	—	—	—	5		5
Cash dividends declared	—	—	—	(52	)	—	(52
Balance at June 30, 2017	62.7	1	1,966	1,217	(414	)	2,770

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

DOMTAR CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN MILLIONS OF DOLLARS)

	For the six months ended June 30June 30, 2017 2016 (Unaudited) \$ \$	
Operating activities		
Net earnings	58	22
Adjustments to reconcile net earnings to cash flows from operating activities		
Depreciation and amortization	159	176
Deferred income taxes and tax uncertainties	(12)	(5)
Impairment of property, plant and equipment	—	24
Stock-based compensation expense	3	3
Other	—	(4)
Changes in assets and liabilities, excluding the effect of acquisition of business		
Receivables	11	25
Inventories	10	18
Prepaid expenses	(4)	(13)
Trade and other payables	(35)	(8)
Income and other taxes	21	(16)
Difference between employer pension and other post-retirement contributions and pension and other post-retirement expense	—	(3)
Other assets and other liabilities	1	(4)
Cash flows from operating activities	212	215
Investing activities		
Additions to property, plant and equipment	(71)	(219)
Acquisition of business, net of cash acquired	—	(1)
Cash flows used for investing activities	(71)	(220)
Financing activities		
Dividend payments	(52)	(50)
Stock repurchase	—	(10)
Net change in bank indebtedness	(12)	1
Change in revolving credit facility	(30)	(50)
Proceeds from receivables securitization facility	25	120
Repayments of receivables securitization facility	(15)	(20)
Repayments of long-term debt	(63)	(1)
Other	(1)	(1)
Cash flows used for financing activities	(148)	(11)
Net decrease in cash and cash equivalents	(7)	(16)
Impact of foreign exchange on cash	6	1

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Cash and cash equivalents at beginning of period	125	126
Cash and cash equivalents at end of period	124	111
Supplemental cash flow information		
Net cash payments for:		
Interest	31	32
Income taxes	15	27

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

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DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 1.

BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, in the opinion of Management, include all adjustments that are necessary for the fair statement of Domtar Corporation's ("the Company") financial position, results of operations, and cash flows for the interim periods presented. Results for the first 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, 2016, as filed with the Securities and Exchange Commission. The December 31, 2016 Consolidated Balance Sheet, presented for comparative purposes in this interim report, was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 2.

RECENT ACCOUNTING PRONOUNCEMENTS

ACCOUNTING CHANGES IMPLEMENTED

INVENTORY

In July 2015, the FASB issued Accounting Standard Update (“ASU”) 2015-11, “Simplifying the Measurement of Inventory,” which simplifies the measurement of inventories valued under FIFO – first-in, first-out – and moving average methods. Under this new guidance, inventories valued under these methods would be valued at the lower of cost or net realizable value. Net realizable value is defined as the estimated selling prices less reasonable costs to sell the inventory. This ASU does not change the measurement principles for inventories valued under the LIFO – last-in, first-out – method.

The Company adopted the new guidance on January 1, 2017 with no impact on the consolidated financial statements.

SHARE-BASED PAYMENTS

In March 2016, the FASB issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting,” which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows.

The Company adopted the new guidance on January 1, 2017 with no significant impact on the consolidated financial statements.

FUTURE ACCOUNTING CHANGES

REVENUE FROM CONTRACTS WITH CUSTOMERS

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers.” The core principal of this guidance is that an entity should recognize revenue, to depict the transfer of promised goods or services to customers,

in an amount that reflects the consideration for which the entity is entitled to, in exchange for those goods and services. This new guidance will supersede the revenue recognition requirements found in topic 605.

ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017 including interim periods within that reporting period. Early adoption is permitted only for annual and interim periods beginning after December 15, 2016.

Entities are permitted to adopt the new revenue standard by restating all prior periods under the full retrospective approach following ASC 250 "Accounting Changes and Error Corrections" or entities can elect to use a modified retrospective approach. Under the modified retrospective approach, entities will recognize the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings in the period of initial application and comparative prior year periods would not be adjusted.

The Company is assessing the impact that the guidance will have on the consolidated financial statements and related disclosures. The Company currently expects to adopt the new revenue standards in its first quarter of 2018 utilizing the full retrospective transition method. Further, the Company expects to identify similar performance obligations under the new guidance as compared with deliverables previously identified. As a result, the Company expects the timing and amount of its revenue to remain substantially the same.

The Company does not expect this new guidance to have a material impact on the consolidated financial statements aside from the additional required disclosures related to revenue in the notes thereto.

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DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)

FINANCIAL INSTRUMENTS

In January 2016, the FASB issued ASU 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities,” which amends the guidance on the classification and measurement of financial instruments. Although the ASU retains many current requirements, it significantly revises an entity’s accounting related to the classification and measurement of investments in equity securities and the presentation of certain fair value changes for financial liabilities measured at fair value. The ASU also amends certain disclosure requirements associated with the fair value of financial instruments.

The amendments in this update are effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017. To adopt the amendments, companies will be required to make a cumulative-effect adjustment to beginning retained earnings as of the beginning of the fiscal year in which the guidance is effective. Early adoption is permitted.

The Company does not expect this new guidance to have a material impact on the consolidated financial statements.

LEASES

In February 2016, the FASB issued ASU 2016-02, “Leases,” which requires lessees to recognize a right-of-use asset and a lease liability for all of their leases with a lease term greater than 12 months while continuing to recognize expenses in the statement of earnings in a manner similar to current accounting standards. For lessors, the new standard modifies the classification criteria and the accounting for sales-type and direct financing leases.

As a lessee, Domtar’s various leases under existing guidance are classified as operating leases that are not recorded on the balance sheet but are recorded in the statement of earnings as expense is incurred. Upon adoption of the new guidance, the Company will be required to record substantially all leases on the Consolidated Balance Sheets as a right-of-use asset and a lease liability. The timing of expense recognition and classification in the Consolidated Statements of Earnings and Comprehensive Income could change based on the classification of leases as either operating or financing.

This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted as of the beginning of an interim or annual reporting period.

The Company will adopt the ASU on January 1, 2019 using the modified retrospective approach required by the guidance. The Company is currently evaluating the impact of this guidance on the consolidated financial statements, including analyzing all contracts that contain a lease.

DERIVATIVES AND HEDGING

In March 2016, the FASB issued ASU 2016-05, “Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships,” which clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument or a change in a critical term of the hedging relationship. As long as all other hedge accounting criteria in ASC 815 are met, a hedging relationship in which the hedging derivative instrument is novated would not be discontinued or require redesignation. This clarification applies to both cash flow and fair value hedging relationships. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted as of the beginning of an interim or annual reporting period.

The Company does not expect this new guidance to have a material impact on the consolidated financial statements.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)

CLASSIFICATION OF CASH FLOWS

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows,” which amends ASC 230 to add or clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The guidance must be applied retrospectively to all periods presented but it may be applied prospectively if retrospective application would be impracticable. Early adoption is permitted.

The Company does not expect this new guidance to have a material impact on the consolidated financial statements.

GOODWILL IMPAIRMENT

In January 2017, the FASB issued ASU 2017-04, “Simplifying the Test for Goodwill Impairment,” which removes the requirement for an entity to calculate the implied fair value of goodwill in measuring a goodwill impairment loss, referred to as the Step II test. As a result, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount for which the carrying value exceeds the reporting unit’s fair value. The impairment loss recognized should be recorded against goodwill and should not exceed the total amount of goodwill allocated to that reporting unit. This ASU is effective for annual or any interim goodwill impairment tests performed in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests with measurement dates after January 1, 2017.

The Company expects to adopt this new guidance concurrently with its 2017 annual goodwill impairment test.

RETIREMENT BENEFITS

In March 2017, the FASB issued ASU 2017-07, “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,” which requires an entity to present the service cost component of the net

periodic benefit cost with other employee compensation costs in operating income. Only the service cost components will be eligible for capitalization in assets. The other components of the net periodic benefit cost (i.e., interest expense, expected return on plan assets, amortization of actuarial gains or losses and amortization of prior year service costs) will be presented outside of any subtotal of operating income. An appropriate disclosure of the line(s) used to present other components of net periodic benefit costs is required if the components are not presented separately in the statement of earnings. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted as of the beginning of an annual period for which financial statements have not been issued or made available for issuance.

The Company will adopt the ASU on January 1, 2018 using a retrospective approach for the presentation of the service cost component and the other components of net periodic benefit costs in the Consolidated Statement of Earnings and prospectively for the capitalization of the service cost component of net periodic benefit costs in assets. The guidance includes a practical expedient that permits an entity to estimate amounts for comparative periods using the information previously disclosed in its pension plans and other post-retirement benefit plans footnote.

While the Company is still evaluating the impact of adopting this new guidance, it does not expect this new guidance to have a material impact on the consolidated earnings.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 3.

DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT

HEDGING PROGRAMS

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

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

CREDIT RISK

The Company is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, the Company reviews new customers' credit history before granting credit and conducts regular reviews of existing customers' credit performance. As of June 30, 2017, one of Domtar's Pulp and Paper segment customers located in the U.S. represented 12% or \$74 million (2016 – 12% or \$74 million) of the Company's receivables.

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

INTEREST RATE RISK

The Company is exposed to interest rate risk arising from fluctuations in interest rates on its cash and cash equivalents, bank indebtedness, revolving credit facility and long-term debt. The Company's objective in managing

exposure to interest rate changes is to minimize the impact of interest rate changes on earnings and cash flows and to lower its overall borrowing costs. The Company may manage this interest rate exposure through the use of derivative instruments such as interest rate swap contracts, whereby it agrees to exchange the difference between fixed and variable interest amounts calculated by reference to an agreed upon notional principal amount.

COST RISK

Cash flow hedges:

The Company is exposed to price volatility for raw materials and energy used in its manufacturing process. The Company manages its exposure to cost risk primarily through the use of supplier contracts. The Company purchases natural gas at the prevailing market price at the time of delivery. To reduce the impact on cash flow and earnings due to pricing volatility, the Company may utilize derivatives to fix the price of forecasted natural gas purchases. The changes in the fair value on qualifying instruments are included in Accumulated other comprehensive loss to the extent effective, and reclassified into Cost of sales in the period during which the hedged transaction affects earnings. Current contracts are used to hedge a portion of forecasted purchases over the next 60 months.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(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, 2017 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
Natural Gas	MMBTU ⁽³⁾		
2017 ⁽¹⁾	4,255,000	\$ 13	35%
2018	12,695,000	\$ 38	50%
2019	9,175,000	\$ 28	36%
2020	5,750,000	\$ 18	23%
2021	3,920,000	\$ 12	15%
2022 ⁽²⁾	2,070,000	\$ 6	15%

⁽¹⁾Represents the remaining six months of 2017

⁽²⁾Represents the first six months of 2022

⁽³⁾MMBTU: Millions of British thermal units

The natural gas derivative contracts were fully effective as of June 30, 2017. There were no amounts reflected in the Consolidated Statements of Earnings and Comprehensive Income for the three and six months ended June 30, 2017 resulting from hedge ineffectiveness (three and six months ended June 30, 2016 – nil).

FOREIGN CURRENCY RISK

Cash flow hedges:

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

Derivatives are used to hedge forecasted purchases in Canadian dollars by the Company's Canadian subsidiary over the next 24 months and to hedge a portion of forecasted sales by its U.S. subsidiaries in British pounds over the next 6 months. Derivatives are also currently used to hedge a portion of forecasted sales in British pounds and Norwegian krone and a portion of forecasted purchases in U.S. dollars and Swedish krona by its European subsidiaries over the next 12 months. Such derivatives are designated as cash flow hedges. The changes in the fair value on qualifying instruments are included in Accumulated other comprehensive loss to the extent effective, and reclassified into Sales or Cost of sales in the period during which the hedged transaction affects earnings.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(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 significant currency positions pursuant to currency derivatives outstanding as of June 30, 2017 to hedge forecasted purchases and sales:

Currency exposure hedged	Business Segment	Year of maturity 2017 ⁽¹⁾	Notional contractual value	Percentage of forecasted net exposures under contracts	Average Protection rate	Average Obligation rate
CDN/USD	Pulp and Paper		254 CDN	66%	1 USD = 1.3200	1 USD = 1.3712
USD/Euro	Personal Care		27 USD	77%	1 Euro = 1.1345	1 Euro = 1.1345
		2018				
CDN/USD	Pulp and Paper		374 CDN	48%	1 USD = 1.3026	1 USD = 1.3547
USD/Euro	Personal Care		26 USD	36%	1 Euro = 1.1218	1 Euro = 1.1218
		2019				
CDN/USD	Pulp and Paper		101 CDN	13%	1 USD = 1.2897	1 USD = 1.3471

⁽¹⁾Represents the remaining six months of 2017

The foreign exchange derivative contracts were fully effective as of June 30, 2017. There were no amounts reflected in the Consolidated Statements of Earnings and Comprehensive Income for the three and six months ended June 30, 2017 resulting from hedge ineffectiveness (three and six months ended June 30, 2016 – nil).

FAIR VALUE MEASUREMENT

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

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

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

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

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DOMTAR CORPORATION

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(UNAUDITED)

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

The following tables present information about the Company's financial assets and financial liabilities measured at fair value on a recurring basis (except Long-term debt, see (b) below) at June 30, 2017 and December 31, 2016, in accordance with the accounting standards for fair value measurements and disclosures and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

Fair Value of financial instruments at:	June 30, 2017	Quoted prices in active markets for identical assets (Level 1)	Significant inputs (Level 2)	Significant observable inputs (Level 3)	unobservable inputs (Level 3)	Balance sheet classification
Derivatives designated as hedging instruments:						
Asset derivatives						
Currency derivatives	13	—	13	—	—	(a) Prepaid expenses
Natural gas swap contracts	3	—	3	—	—	(a) Prepaid expenses
Currency derivatives	6	—	6	—	—	(a) Other assets
Total Assets	22	—	22	—	—	
Liabilities derivatives						
Currency derivatives	3	—	3	—	—	(a) Trade and other payables
Natural gas swap contracts	2	—	2	—	—	(a) Trade and other payables

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Currency derivatives	3	—	3	—	(a) Other liabilities and deferred credits
Natural gas swap contracts	4	—	4	—	(a) Other liabilities and deferred credits
Total Liabilities	12	—	12	—	

Other Instruments:

Stock-based compensation -

liability awards	2	2	—	—	Trade and other payables
Stock-based compensation -					
liability awards	15	15	—	—	Other liabilities and deferred credits
Long-term debt	1,272	—	1,272	—	(b) Long-term debt

The net cumulative loss recorded in Accumulated other comprehensive loss relating to natural gas contracts is \$3 million at June 30, 2017, of which a gain of \$1 million 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, 2017.

The net cumulative gain recorded in Accumulated other comprehensive loss relating to currency options and forwards hedging forecasted purchases is \$13 million at June 30, 2017, of which a gain of \$10 million will be recognized in Cost of sales or 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, 2017.

DOMTAR CORPORATION

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

Fair Value of financial instruments at:	December 31, 2016	Quoted prices in active markets for identical assets	Significant observable inputs	Significant unobservable inputs	Balance sheet classification
		(Level 1)	(Level 2)	(Level 3)	
		\$	\$	\$	
Derivatives designated as hedging instruments:					
Asset derivatives					
Currency derivatives	18	—	18	—	(a) Prepaid expenses
Natural gas swap contracts	6	—	6	—	(a) Prepaid expenses
Currency derivatives	6	—	6	—	(a) Other assets
Natural gas swap contracts	2	—	2	—	(a) Other assets
Total Assets	32	—	32	—	
Liabilities derivatives					
Currency derivatives	10	—	10	—	(a) Trade and other payables
Natural gas swap contracts	1	—	1	—	(a) Trade and other payables
Currency derivatives	6	—	6	—	(a) Other liabilities and deferred credits
Natural gas swap contracts	4	—	4	—	(a) Other liabilities and deferred credits
Total Liabilities	21	—	21	—	

Other Instruments:

Stock-based compensation -

liability awards	2	2	—	—	Trade and other payables
Stock-based compensation -					
liability awards	17	17	—	—	Other liabilities and deferred credits
Long-term debt	1,313	—	1,313	—	(b) Long-term debt

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

- For currency derivatives: Fair value is measured using techniques derived from the Black-Scholes pricing model. Interest rates, forward market rates and volatility are used as inputs for such valuation techniques.
- For natural gas contracts: Fair value is measured using the discounted difference between contractual rates and quoted market future rates.

(b) Fair value of the Company's long-term debt is measured by comparison to market prices of its debt. The Company's long-term debt is not carried at fair value on the Consolidated Balance Sheets at June 30, 2017 and December 31, 2016. However, fair value disclosure is required. The carrying value of the Company's long-term debt is \$1,204 million and \$1,281 million at June 30, 2017 and December 31, 2016, respectively.

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

DOMTAR CORPORATION

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NOTE 4.

EARNINGS PER COMMON SHARE

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

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
Net earnings	\$38	\$ 18	\$58	\$ 22
Weighted average number of common shares				
outstanding (millions)	62.6	62.6	62.6	62.7
Effect of dilutive securities (millions)	0.1	0.1	0.1	0.1
Weighted average number of diluted common shares				
outstanding (millions)	62.7	62.7	62.7	62.8
Basic net earnings per common share (in dollars)	\$0.61	\$ 0.29	\$0.93	\$ 0.35
Diluted net earnings per common share (in dollars)	\$0.61	\$ 0.29	\$0.93	\$ 0.35

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

For the three months ended	For the six months ended
-------------------------------	-----------------------------

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	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Options	517,246	314,287	419,161	412,372

DOMTAR CORPORATION

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NOTE 5.

PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS

DEFINED CONTRIBUTION PLANS

The Company has several defined contribution plans and multiemployer plans. The pension expense under these plans is equal to the Company's contribution. For the three and six months ended June 30, 2017, the pension expense was \$8 million and \$19 million, respectively (2016 – \$8 million and \$18 million, respectively).

DEFINED BENEFIT PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS

The Company sponsors both contributory and non-contributory U.S. and non-U.S. defined benefit pension plans. Non-unionized employees in Canada joining the Company after January 1, 1998 participate in a defined contribution pension plan. Salaried employees in the U.S. joining the Company after January 1, 2008 participate in a defined contribution pension plan. Unionized and non-union hourly employees in the U.S. who are not grandfathered under the existing defined benefit pension plans, participate in a defined contribution pension plan for future service. The Company also sponsors a number of other post-retirement benefit plans for eligible U.S. and non-U.S. employees; the plans are unfunded and include life insurance programs and medical and dental benefits. The Company also provides supplemental unfunded defined benefit pension plans and supplemental unfunded defined contribution pension plans to certain senior management employees.

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

	For the three months ended June 30, 2017		For the six months ended June 30, 2017	
	Other		Other	
	Pension plans	post-retirement benefit plans	Pension plans	post-retirement benefit plans
	\$	\$	\$	\$
Service cost	7	1	15	1
Interest expense	13	1	25	2

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Expected return on plan assets	(20)	—	(40)	—
Amortization of net actuarial loss	2	—	4	—
Amortization of prior year service costs	2	—	3	—
Net periodic benefit cost	4	2	7	3

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

	For the three months ended June 30, 2016		For the six months ended June 30, 2016	
	Other		Other	
	Pension plans	post-retirement benefit plans	Pension plans	post-retirement benefit plans
	\$	\$	\$	\$
Service cost	8	1	16	1
Interest expense	13	1	25	2
Expected return on plan assets	(20)	—	(39)	—
Amortization of net actuarial loss	1	—	2	—
Amortization of prior year service costs	1	—	2	—
Net periodic benefit cost	3	2	6	3

For the three and six months ended June 30, 2017, the Company contributed \$3 million and \$6 million, respectively (2016 – \$5 million and \$9 million, respectively) to the pension plans and \$1 million and \$2 million, respectively (2016 – \$1 million and \$2 million, respectively) to the other post-retirement benefit plans.

DOMTAR CORPORATION

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NOTE 6.

OTHER OPERATING LOSS, NET

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

	For the three months ended		For the six months ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
	\$	\$	\$	\$
Bad debt expense	1	—	1	—
Environmental provision	2	—	2	—
Litigation settlement	—	2	—	2
Foreign exchange loss	—	—	1	4
Other	(1)	(2)	(3)	(2)
Other operating loss, net	2	—	1	4

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(UNAUDITED)

NOTE 7.

INCOME TAXES

For the second quarter of 2017, the Company's income tax expense was \$9 million, consisting of a current income tax expense of \$17 million and a deferred income tax benefit of \$8 million. This compares to an income tax expense of \$6 million in the second quarter of 2016, consisting of a current income tax expense of \$8 million and a deferred income tax benefit of \$2 million. The effective tax rate was 19% compared with an effective tax rate of 25% in the second quarter of 2016. The effective tax rate for the second quarter of 2017 was favorably impacted by enacted law changes in several U.S. states and by the recognition of additional tax credits associated with the filing of certain 2016 income tax returns.

For the first half of 2017, the Company's income tax expense amounted to \$14 million, consisting of a current income tax expense of \$26 million and a deferred income tax benefit of \$12 million. This compares to an income tax expense of \$3 million in the first half of 2016, consisting of a current income tax expense of \$8 million and a deferred income tax benefit of \$5 million. The effective tax rate was 19% compared to an effective tax rate of 12% in the first half of 2016. The effective tax rate for the first half of 2017 was favorably impacted by the recognition of previously unrecognized tax benefits due to a statute expiration in a foreign jurisdiction and also a U.S. state tax audit finalization, enacted law changes in several U.S. states, and the recognition of additional tax credits associated with the filing of certain 2016 income tax returns. The effective tax rate for the first half of 2016 was impacted by the approval of a state tax credit in the U.S.

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NOTE 8.

INVENTORIES

The following table presents the components of inventories:

	June 30, 2017	December 31, 2016
	\$	\$
Work in process and finished goods	405	413
Raw materials	135	132
Operating and maintenance supplies	219	214
	759	759

DOMTAR CORPORATION

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NOTE 9.

GOODWILL

Changes in the carrying value of goodwill are as follows:

	June 30, 2017 \$
Balance at December 31, 2016	550
Effect of foreign currency exchange rate change	19
Balance at end of period	569

The goodwill at June 30, 2017 is entirely related to the Personal Care segment.

DOMTAR CORPORATION

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NOTE 10.

 INTANGIBLE ASSETS

The following table presents the components of intangible assets:

	Estimated useful lives (in years)	June 30, 2017			December 31, 2016		
		Gross		Net	Gross		Net
		carrying amount	accumulated amortization		carrying amount	accumulated amortization	
		\$	\$	\$	\$	\$	\$
Definite-lived intangible							
assets subject							
to amortization							
Water rights	40	3	(1)	2	3	(1)	2
Customer relationships	10 – 40	383	(70)	313	369	(60)	309
Technology	7 – 20	8	(3)	5	8	(3)	5
Non-Compete	9	1	(1)	—	1	—	1
License rights	12	29	(10)	19	28	(8)	20
		424	(85)	339	409	(72)	337
Indefinite-lived intangible							
assets not subject							
to amortization							
Water rights		4	—	4	4	—	4
Trade names		237	—	237	225	—	225
License rights		6	—	6	6	—	6
Catalog rights		39	—	39	36	—	36
Total		710	(85)	625	680	(72)	608

Amortization expense related to intangible assets for the three and six months ended June 30, 2017 was \$5 million and \$10 million, respectively (2016 – \$4 million and \$9 million, respectively).

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

	2017	2018	2019	2020	2021
	\$	\$	\$	\$	\$
Amortization expense related to intangible assets	21	21	21	21	20

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 11.

CLOSURE AND RESTRUCTURING COSTS AND LIABILITY AND IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT

Ashdown, Arkansas mill

On December 10, 2014, the Company announced a project to convert a paper machine at its Ashdown, Arkansas mill to a high quality fluff pulp line used in absorbent applications such as baby diapers, feminine hygiene and adult incontinence products. The Company also invested in a pulp bale line that will provide flexibility to manufacture papergrade softwood pulp, contingent on market conditions. The conversion work commenced during the second quarter of 2016 and the production of bale softwood pulp began in the third quarter of 2016. The fluff pulp line will allow for the production of up to 516,000 metric tons of fluff pulp per year once the machine is in full operation. The project resulted in the permanent reduction of 364,000 short tons of annual uncoated freesheet production capacity on March 31, 2016.

The Company recorded \$3 million and \$24 million for the three and six months ended June 30, 2016, respectively, of accelerated depreciation under Impairment of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive Income. The Company also recorded \$21 million of costs related to the fluff pulp conversion outage under Closure and restructuring costs during the second quarter of 2016. During the first quarter of 2016, the Company recorded \$1 million of severance and termination costs under Closure and restructuring costs.

Other costs

For the three and six months ended June 30, 2016, other costs related to previous and ongoing closures include nil and \$1 million, respectively, of severance and termination costs related to Pulp and Paper.

DOMTAR CORPORATION

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NOTE 12.

CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT

The following table presents the changes in Accumulated other comprehensive loss by component⁽¹⁾ for the six months ended June 30, 2017 and the year ended December 31, 2016:

	Net derivative		Post-retirement		Foreign currency	Total
	(losses) gains		benefit items ⁽²⁾		items	
	on		cash flow			
	hedges	Pension items ⁽²⁾	benefit items ⁽²⁾	items		
	\$	\$	\$	\$		\$
Balance at December 31, 2015	(30)	(190)	(10)	(271)		(501)
Natural gas swap contracts	4	N/A	N/A	N/A		4
Net investment hedge	(1)	N/A	N/A	N/A		(1)
Currency options	8	N/A	N/A	N/A		8
Foreign exchange forward contracts	16	N/A	N/A	N/A		16
Net gain	N/A	(38)	(1)	N/A		(39)
Foreign currency items	N/A	N/A	N/A	(7)		(7)
Other comprehensive income (loss)						
before reclassifications	27	(38)	(1)	(7)		(19)
Amounts reclassified from Accumulated						
other comprehensive loss	14	7	—	—		21
Net current period other comprehensive						
income (loss)	41	(31)	(1)	(7)		2
Balance at December 31, 2016	11	(221)	(11)	(278)		(499)
Natural gas swap contracts	(4)	N/A	N/A	N/A		(4)

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Currency options	6	N/A	N/A	N/A	6
Foreign currency items	N/A	N/A	N/A	82	82
Other comprehensive income					
before reclassifications	2	—	—	82	84
Amounts reclassified from Accumulated					
other comprehensive loss	(4	) 5	—	—	1
Net current period other comprehensive					
(loss) income	(2	) 5	—	82	85
Balance at June 30, 2017	9	(216	) (11	) (196	) (414)

⁽¹⁾All amounts are after tax. Amounts in parenthesis indicate losses.

⁽²⁾The accrued benefit obligation is actuarially determined on an annual basis as of December 31.

DOMTAR CORPORATION

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NOTE 12. CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT
(CONTINUED)

The following table presents reclassifications out of Accumulated other comprehensive loss:

Details about Accumulated other comprehensive loss components	Amounts reclassified from	
	Accumulated other	comprehensive loss ⁽¹⁾
	For the three months ended	For the three months ended
	June 30, 2017	June 30, 2016
	\$	\$
Net derivative (losses) gains on cash flow hedge		
Natural gas swap contracts	—	5 (2)
Currency options and forwards	(1)	3 (2)
Total before tax	(1)	8
Tax expense	—	(3)
Net of tax	(1)	5
Amortization of defined benefit pension items		
Amortization of net actuarial loss and prior year		
service cost	4	3 (3)
Tax expense	(1)	(1)
Net of tax	3	2

Details about Accumulated other comprehensive loss components	Amounts reclassified from		
	Accumulated other		
	comprehensive loss ⁽¹⁾		
	For the six months ended		
	June 30, 2017	June 30, 2016	
	\$	\$	
Net derivative (losses) gains on cash flow hedges			
Natural gas swap contracts	(1)	10	(2)
Currency options and forwards	(5)	11	(2)
Total before tax	(6)	21	
Tax benefit (expense)	2	(8)	
Net of tax	(4)	13	
Amortization of defined benefit pension items			
Amortization of net actuarial loss and prior year			
service cost	7	5	(3)
Tax expense	(2)	(2)	
Net of tax	5	3	

⁽¹⁾ Amounts in parentheses indicate losses.

⁽²⁾ These amounts are included in Cost of Sales in the Consolidated Statements of Earnings and Comprehensive Income.

⁽³⁾ These amounts are included in the computation of net periodic benefit cost (see Note 5 "Pension Plans and Other Post-Retirement Benefit Plans" for more details).

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NOTE 13.

SHAREHOLDERS' EQUITY

On February 21, 2017 and May 3, 2017, the Company's Board of Directors approved a quarterly dividend of \$0.415 per share, respectively, to be paid to holders of the Company's common stock. Dividends of \$26 million were paid on April 17, 2017 and July 17, 2017, respectively, to shareholders of record on April 3, 2017 and July 3, 2017, respectively.

On August 1, 2017, the Company's Board of Directors approved a quarterly dividend of \$0.415 per share to be paid to holders of the Company's common stock. This dividend is to be paid on October 16, 2017, to shareholders of record on October 2, 2017.

STOCK REPURCHASE PROGRAM

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

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

During the first half of 2017, there were no shares repurchased under the Program.

During the first half of 2016, the Company repurchased 304,915 shares at an average price of \$32.21 for a total cost of \$10 million.

Since the inception of the Program, the Company has repurchased 24,853,827 shares at an average price of \$39.33 for a total cost of \$977 million. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

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NOTE 14.

 COMMITMENTS AND CONTINGENCIES

ENVIRONMENT

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

On February 16, 2010, the government of British Columbia issued a Remediation Order to Seaspan International Ltd. (“Seaspan”) and the Company, in order to define and implement a remediation plan to address soil, sediment and groundwater issues. Construction began in January 2017. The Company has previously recorded an environmental reserve to address its estimated exposure. The possible cost in excess of the reserve is not considered to be material for this matter.

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

	June 30, 2017 \$
Balance at beginning of year	50
Additions	2
Environmental spending	(3)
Effect of foreign currency exchange rate change	1
Balance at end of period	50

The U.S. Environmental Protection Agency (“EPA”) and/or various state agencies have notified the Company that it may be a potentially responsible party under the Comprehensive Environmental Response Compensation and Liability Act, commonly known as “Superfund,” and similar state laws with respect to other hazardous waste sites as to which no proceedings have been instituted against the Company. The Company continues to take remedial action under its Care and Control Program at its former wood preserving sites, and at a number of operating sites, due to possible soil, sediment or groundwater contamination.

Climate change regulation

Various national and local laws and regulations have been established or are emerging in jurisdictions where the Company currently has, or may have in the future, manufacturing facilities or investments. The Company does not expect to be disproportionately affected by these measures compared with other pulp and paper producers located in these jurisdictions.

The United States EPA Clean Power Plan regulation is being litigated and has been stayed. President Trump issued an Executive Order on March 28, 2017, directing his Administration to review and then suspend, revise, or rescind the Clean Power Plan, as appropriate and consistent with law. As a result, the EPA filed a motion with the D.C. Circuit to hold the case in abeyance while it reconsiders the rule, which the D.C. Circuit granted in part to allow time for additional briefing on how and whether the litigation should proceed. Regardless of the outcome of the litigation and/or the Executive Order, the Company does not expect to be disproportionately affected compared with other pulp and paper producers located in the states where the Company operates.

The Government of Canada is reviewing national policies to further reduce greenhouse gases (“GHG”) and has announced its intent to impose a cost on carbon emissions. The Company does not expect its facilities to be disproportionately affected by these measures compared with other pulp and paper producers in Canada.

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NOTE 14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

The provinces of Quebec and Ontario have GHG cap-and-trade systems with reduction targets. British Columbia has a carbon tax that applies to the purchase of fossil fuels within the province. The Company does not expect to be disproportionately affected compared to the other pulp and paper producers located in these provinces.

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, 2017, cannot be predicted with certainty, it is management's opinion that their resolution will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Spanish Competition Investigation

On October 15, 2015, the Competition Directorate of Spain's National Commission of Markets and Competition ("CNMC") filed a Statement of Objections against a number of industry participants alleging the existence of a series of agreements between manufacturers, distributors and pharmacists to fix prices and to allocate margins for heavy adult incontinence products within the pharmacy channel in Spain during the period from December 1996 through January 2014. Among the parties named in the Statement of Objections was Indas, which the Company acquired in January 2014, and two of its affiliates.

On January 4, 2016, the Competition Directorate issued a proposed decision confirming the allegations of the Statement of Objections. The proposed decision recommended the imposition of fines on the parties without recommending the amount of any fines. The Company recorded a €0.2 million (\$0.2 million) provision in the fourth quarter of 2015 in Other operating loss, net.

On May 26, 2016, the CNMC rendered its final decision, which declared that a number of manufacturers of adult heavy incontinence products, the sector association and certain individuals participated in price fixing during the period from December 1996 through January 2014. Indas and one of its subsidiaries were fined a total of €13.5 million

(\$14.9 million) for their participation. A provision was recorded in the second quarter of 2016 in the amount of €13.3 million (\$14.7 million) in Other operating loss, net.

The sellers of Indas made representations and warranties to the Company in the purchase agreement regarding, among other things, Indas' and its subsidiary's compliance with competition laws. The liability retained by the sellers was backed by a retained purchase price of €3 million (\$3.3 million) and bank guarantees of €9 million (\$9.9 million).

On June 27, 2016, in light of the CNMC decision, the sellers, in terms of their indemnity obligations, agreed to the appropriation by the Company of the retained purchase price and the release of the bank guarantees. Accordingly, a recovery of €12 million (\$13.2 million) was recorded in the second quarter of 2016 and included in Other operating loss, net.

In July 2016, the fines were paid and Indas and two of its affiliates named in the final decision appealed the decision to the Spanish courts.

The Company purchased limited insurance coverage with respect to the purchase agreement, and is seeking to recover the remaining €1.5 million (\$1.7 million) under the insurance policy. Any recovery from the insurers would be recorded in the period when the proceeds are received.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 14. COMMITMENTS AND CONTINGENCIES (CONTINUED)

INDEMNIFICATIONS

In the normal course of business, the Company offers indemnifications relating to the sale of its businesses and real estate. In general, these indemnifications may relate to claims from past business operations, the failure to abide by covenants and the breach of representations and warranties included in the sales agreements. Typically, such representations and warranties relate to taxation, environmental, product and employee matters. The terms of these indemnification agreements are generally for an unlimited period of time. At June 30, 2017, the Company is unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provision has been recorded. These indemnifications have not yielded a significant expense in the past.

Pension Plans

The Company has indemnified and held harmless the trustees of its pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions from the Company or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. At June 30, 2017, the Company has not recorded a liability associated with these indemnifications, as it does not expect to make any payments pertaining to these indemnifications.

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 15.

SEGMENT DISCLOSURES

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

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

Personal Care – consists of the design, manufacturing, marketing and distribution of absorbent hygiene products. An analysis and reconciliation of the Company's business segment information to the respective information in the financial statements is as follows:

SEGMENT DATA	For the three months ended June 30, June 30, 2017 2016		For the six months ended June 30, June 30, 2017 2016	
	\$	\$	\$	\$
Sales by segment				
Pulp and Paper	999	1,054	2,072	2,139
Personal Care	241	228	490	444
Total for reportable segments	1,240	1,282	2,562	2,583
Intersegment sales	(16)	(15)	(34)	(29)
Consolidated sales	1,224	1,267	2,528	2,554
Sales by product group				
Paper	734	816	1,520	1,660
Market pulp	249	223	518	450
Absorbent hygiene products	241	228	490	444
Consolidated sales	1,224	1,267	2,528	2,554

Depreciation and amortization

of property, plant and equipment				
Pulp and Paper	63	72	127	145
Personal Care	16	15	32	31
Total for reportable segments	79	87	159	176
Impairment of property, plant and				
equipment - Pulp and Paper	—	3	—	24
Consolidated depreciation and amortization and impairment				
of property, plant and equipment	79	90	159	200
Operating income (loss)				
Pulp and Paper	65	35	99	54
Personal Care	13	15	29	29
Corporate	(14)	(11)	(22)	(26)
Consolidated operating income	64	39	106	57
Interest expense, net	17	15	34	32
Earnings before income taxes	47	24	72	25
Income tax expense	9	6	14	3
Net earnings	38	18	58	22

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16.

SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION

The following information is presented as required under Rule 3-10 of Regulation S-X, in connection with the Company's issuance of debt securities that are fully and unconditionally guaranteed by Domtar Paper Company, LLC, a 100% owned subsidiary of the Company, Domtar Industries LLC (and subsidiaries, excluding Domtar Funding LLC), Domtar A.W. LLC, Attends Healthcare Products Inc., EAM Corporation, Associated Hygienic Products LLC and Home Delivery Incontinent Supplies Co., all 100% owned subsidiaries of the Company ("Guarantor Subsidiaries"), on a joint and several basis. Pursuant to the amendment and restatement of the 2016 Credit Agreement on August 18, 2016, the Guaranteed Debt will not be guaranteed by certain of Domtar's 100% owned subsidiaries; including Domtar Delaware Holdings Inc. and its foreign subsidiaries, including Attends Healthcare Limited, Domtar Inc. and Laboratorios Indas. S.A.U.. Also excluded are Ariva Distribution Inc., Domtar Delaware Investments Inc., Domtar Delaware Holdings LLC, Domtar AI Inc., Domtar Personal Care Absorbent Hygiene Inc., Domtar Wisconsin Dam Corp. and Palmetto Enterprises LLC, (collectively the "Non-Guarantor Subsidiaries"). The subsidiary's guarantee may be released in certain customary circumstances, such as if the subsidiary is sold or sells all of its assets, if the subsidiary's guarantee of the Credit Agreement is terminated or released and if the requirements for legal defeasance to discharge the indenture have been satisfied.

The following supplemental condensed consolidating financial information sets forth, on an unconsolidated basis, the Balance Sheets at June 30, 2017 and December 31, 2016, the Statements of Earnings and Comprehensive Income for the three and six months ended June 30, 2017 and 2016 and the Statements of Cash Flows for the six months ended June 30, 2017 and 2016 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 AND COMPREHENSIVE INCOME	For the three months ended June 30, 2017				
	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$

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Sales	—	1,011	499	(286)	1,224
Operating expenses					
Cost of sales, excluding depreciation and amortization	—	878	376	(286)	968
Depreciation and amortization	—	58	21	—	79
Selling, general and administrative	2	31	78	—	111
Other operating loss, net	—	—	2	—	2
	2	967	477	(286)	1,160
Operating (loss) income	(2)	44	22	—	64
Interest expense (income), net	16	22	(21)	—	17
(Loss) earnings before income taxes	(18)	22	43	—	47
Income tax (benefit) expense	(5)	3	11	—	9
Share in earnings of equity accounted investees	51	32	—	(83)	—
Net earnings	38	51	32	(83)	38
Other comprehensive income	71	76	69	(145)	71
Comprehensive income	109	127	101	(228)	109

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME	For the six months ended June 30, 2017				
	Parent	Non- Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
Sales	—	2,097	1,015	(584)	2,528
Operating expenses					
Cost of sales, excluding depreciation and amortization	—	1,848	779	(584)	2,043
Depreciation and amortization	—	117	42	—	159
Selling, general and administrative	4	64	151	—	219
Other operating (income) loss, net	—	(2)	3	—	1
	4	2,027	975	(584)	2,422
Operating (loss) income	(4)	70	40	—	106
Interest expense (income), net	33	42	(41)	—	34
(Loss) earnings before income taxes	(37)	28	81	—	72
Income tax (benefit) expense	(9)	5	18	—	14
Share in earnings of equity accounted investees	86	63	—	(149)	—
Net earnings	58	86	63	(149)	58
Other comprehensive income	85	94	85	(179)	85
Comprehensive income	143	180	148	(328)	143

For the three months ended
June 30, 2016CONDENSED CONSOLIDATING STATEMENT OF
EARNINGS (LOSS) AND COMPREHENSIVE INCOME
(LOSS)

Non-
Guarantor Guarantor Consolidating

Parent Subsidiaries Subsidiaries Adjustments Consolidated

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	\$	\$	\$	\$	\$
Sales	—	1,040	498	(271)	1,267
Operating expenses					
Cost of sales, excluding depreciation and amortization	—	874	410	(271)	1,013
Depreciation and amortization	—	63	24	—	87
Selling, general and administrative	2	25	77	—	104
Impairment of property, plant and equipment	—	3	—	—	3
Closure and restructuring costs	—	21	—	—	21
Other operating loss (income), net	1	(1)	—	—	—
	3	985	511	(271)	1,228
Operating (loss) income	(3)	55	(13)	—	39
Interest expense (income), net	16	7	(8)	—	15
(Loss) earnings before income taxes	(19)	48	(5)	—	24
Income tax (benefit) expense	(5)	12	(1)	—	6
Share in earnings of equity accounted investees	32	(4)	—	(28)	—
Net earnings (loss)	18	32	(4)	(28)	18
Other comprehensive loss	(14)	(25)	(29)	54	(14)
Comprehensive income (loss)	4	7	(33)	26	4

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME	For the six months ended June 30, 2016				
	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
Sales	—	2,106	1,019	(571)	2,554
Operating expenses					
Cost of sales, excluding depreciation and amortization	—	1,846	788	(571)	2,063
Depreciation and amortization	—	128	48	—	176
Selling, general and administrative	10	52	145	—	207
Impairment of property, plant and equipment	—	24	—	—	24
Closure and restructuring costs	—	23	—	—	23
Other operating loss (income), net	1	(1)	4	—	4
	11	2,072	985	(571)	2,497
Operating (loss) income	(11)	34	34	—	57
Interest expense (income), net	32	16	(16)	—	32
(Loss) earnings before income taxes	(43)	18	50	—	25
Income tax (benefit) expense	(10)	4	9	—	3
Share in earnings of equity accounted investees	55	41	—	(96)	—
Net earnings	22	55	41	(96)	22
Other comprehensive income	100	90	56	(146)	100
Comprehensive income	122	145	97	(242)	122

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DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING BALANCE SHEET	June 30, 2017		Non-	Consolidating	Consolidated
	Parent	Guarantor Subsidiaries	Guarantor Subsidiaries	Adjustments	
	\$	\$	\$	\$	\$
Assets					
Current assets					
Cash and cash equivalents	1	8	115	—	124
Receivables	—	280	333	—	613
Inventories	—	521	238	—	759
Prepaid expenses	9	20	12	—	41
Income and other taxes receivable	—	10	14	(6)	18
Intercompany accounts	281	289	42	(612)	—
Total current assets	291	1,128	754	(618)	1,555
Property, plant and equipment, net	—	1,920	859	—	2,779
Goodwill	—	313	256	—	569
Intangible assets, net	—	273	352	—	625
Investments in affiliates	4,156	2,798	—	(6,954)	—
Intercompany long-term advances	6	81	1,444	(1,531)	—
Other assets	36	—	126	(23)	139
Total assets	4,489	6,513	3,791	(9,126)	5,667
Liabilities and shareholders' equity					
Current liabilities					
Trade and other payables	48	350	229	—	627
Intercompany accounts	235	55	322	(612)	—
Income and other taxes payable	17	—	17	(6)	28
Long-term debt due within one year	—	—	1	—	1
Total current liabilities	300	405	569	(618)	656

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Long-term debt	812	298	93	—	1,203
Intercompany long-term loans	588	942	1	(1,531)	—
Deferred income taxes and other	—	540	160	(23)	677
Other liabilities and deferred credits	19	172	170	—	361
Shareholders' equity	2,770	4,156	2,798	(6,954)	2,770
Total liabilities and shareholders' equity	4,489	6,513	3,791	(9,126)	5,667

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DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING BALANCE SHEET	December 31, 2016		Non-		
	Guarantor		Guarantor	Consolidating	
	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
	\$	\$	\$	\$	\$
Assets					
Current assets					
Cash and cash equivalents	17	14	94	—	125
Receivables	—	305	308	—	613
Inventories	—	548	211	—	759
Prepaid expenses	15	19	6	—	40
Income and other taxes receivable	—	16	15	—	31
Intercompany accounts	331	184	47	(562)	—
Total current assets	363	1,086	681	(562)	1,568
Property, plant and equipment, net	—	2,000	825	—	2,825
Goodwill	—	313	237	—	550
Intangible assets, net	—	279	329	—	608
Investments in affiliates	3,976	2,678	—	(6,654)	—
Intercompany long-term advances	6	80	1,411	(1,497)	—
Other assets	15	18	103	(7)	129
Total assets	4,360	6,454	3,586	(8,720)	5,680
Liabilities and shareholders' equity					
Current liabilities					
Bank indebtedness	—	12	—	—	12
Trade and other payables	48	391	217	—	656
Intercompany accounts	136	115	311	(562)	—
Income and other taxes payable	16	—	6	—	22
Long-term debt due within one year	63	—	—	—	63

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Total current liabilities	263	518	534	(562)	753
Long-term debt	841	299	78	—	1,218
Intercompany long-term loans	560	937	—	(1,497)	—
Deferred income taxes and other	—	556	126	(7)	675
Other liabilities and deferred credits	20	168	170	—	358
Shareholders' equity	2,676	3,976	2,678	(6,654)	2,676
Total liabilities and shareholders' equity	4,360	6,454	3,586	(8,720)	5,680

DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING STATEMENT OF	For the six months ended June 30, 2017				
	Guarantor		Non- Guarantor	Consolidating	
CASH FLOWS	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
	\$	\$	\$	\$	\$
Operating activities					
Net earnings	58	86	63	(149)	58
Changes in operating and intercompany assets and					
liabilities and non-cash items, included in net					
earnings	77	(107)	35	149	154
Cash flows provided from (used for) operating					
activities	135	(21)	98	—	212
Investing activities					
Additions to property, plant and equipment	—	(39)	(32)	—	(71)
Cash flows used for investing activities	—	(39)	(32)	—	(71)
Financing activities					
Dividend payments	(52)	—	—	—	(52)
Net change in bank indebtedness	—	(12)	—	—	(12)
Change in revolving credit facility	(30)	—	—	—	(30)
Proceeds from receivables securitization facility	—	—	25	—	25
Repayments of receivables securitization facility	—	—	(15)	—	(15)
Repayments of long-term debt	(63)	—	—	—	(63)
Increase in long-term advances to related parties	(5)	—	(61)	66	—
Decrease in long-term advances to related parties	—	66	—	(66)	—
Other	(1)	—	—	—	(1)

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Cash flows (used for) provided from financing activities	(151)	54	(51))	—	(148))	
Net (decrease) increase in cash and cash equivalents	(16))	(6))	15	—	(7))
Impact of foreign exchange on cash	—	—	6	—	6			
Cash and cash equivalents at beginning of period	17	14	94	—	125			
Cash and cash equivalents at end of period	1	8	115	—	124			

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DOMTAR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2017

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

(UNAUDITED)

NOTE 16. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)

CONDENSED CONSOLIDATING STATEMENT OF	For the six months ended June 30, 2016		Non-		
	Guarantor	Guarantor	Consolidating		
CASH FLOWS	Parent	Subsidiaries	Subsidiaries	Adjustments	Consolidated
	\$	\$	\$	\$	\$
Operating activities					
Net earnings	22	55	41	(96)	22
Changes in operating and intercompany assets and					
liabilities and non-cash items, included in net					
earnings	24	108	(35)	96	193
Cash flows from operating activities	46	163	6	—	215
Investing activities					
Additions to property, plant and equipment	—	(184)	(35)	—	(219)
Acquisition of business, net of cash acquired	—	(1)	—	—	(1)
Cash flows used for investing activities	—	(185)	(35)	—	(220)
Financing activities					
Dividend payments	(50)	—	—	—	(50)
Stock repurchase	(10)	—	—	—	(10)
Net change in bank indebtedness	—	1	—	—	1
Change in revolving credit facility	(50)	—	—	—	(50)
Proceeds from receivables securitization facility	—	—	120	—	120
Repayments of receivables securitization facility	—	—	(20)	—	(20)
Repayments of long-term debt	—	(1)	—	—	(1)
Increase in long-term advances to related parties	—	—	(60)	60	—
Decrease in long-term advances to related parties	34	26	—	(60)	—

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Other	(1)	—	—	—	(1)
Cash flows (used for) provided from financing					
activities	(77)	26	40	—	(11)
Net (decrease) increase in cash and cash equivalents	(31)	4	11	—	(16)
Impact of foreign exchange on cash	—	—	1	—	1
Cash and cash equivalents at beginning of period	49	2	75	—	126
Cash and cash equivalents at end of period	18	6	87	—	111

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

This Management's Discussion and Analysis ("MD&A") of Financial Condition and Results of Operations should be read in conjunction with Domtar Corporation's unaudited interim financial statements and notes thereto included in the Quarterly Report on Form 10-Q. The MD&A should also be read in conjunction with the historical financial information contained in our Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission ("SEC") on February 24, 2017. Throughout this MD&A, unless otherwise specified, "Domtar Corporation," "the Company," "Domtar," "we," "us" and "our" refers to Domtar Corporation and its subsidiaries. Domtar Corporation's common stock is listed on the New York Stock Exchange and the Toronto Stock Exchange. Except where otherwise indicated, all financial information reflected herein is determined on the basis of accounting principles generally accepted in the United States.

The information contained on our website, www.domtar.com, is not incorporated by reference into this Form 10-Q and should in no way be construed as a part of this or any other report that we file with or furnish to the SEC.

In accordance with industry practice, in this report, the term "ton" or the symbol "ST" refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tons. The term "metric ton" or the symbol "ADMT" refers to an air dry metric ton. In this report, unless otherwise indicated, all dollar amounts are expressed in U.S. dollars, and the term "dollars" and the symbol "\$" refer to U.S. dollars. In the following discussion, unless otherwise noted, references to increases or decreases in income and expense items, prices, contribution to net earnings (loss), and shipment volumes are based on three and six months ended June 30, 2017 and 2016. The three month and six month periods are also referred to as the second quarter and first half of 2017 and 2016. Reference to notes refers to footnotes to the consolidated financial statements and notes thereto included in Item 1 of this Form 10-Q.

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

- Overview

- Highlights for the three month and six month periods ended June 30, 2017

- Outlook

- Consolidated Results of Operations and Segment Review

- Liquidity and Capital Resources

OVERVIEW

We design, manufacture, market and distribute a wide variety of fiber-based products, including communication papers, specialty and packaging papers, and absorbent hygiene products. The foundation of our business is a network of wood fiber converting assets that produce paper grade, fluff and specialty pulp. More than 50% of our pulp production is consumed internally to manufacture paper and other consumer products with the balance sold as market pulp. We are the largest integrated marketer of uncoated freesheet paper in North America serving a variety of customers, including merchants, retail outlets, stationers, printers, publishers, converters and end-users. We are also a marketer and producer of a broad line of incontinence care products as well as infant diapers. To learn more, visit www.domtar.com.

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

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

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

HIGHLIGHTS FOR THE THREE MONTH PERIOD ENDED JUNE 30, 2017

Operating income and net earnings increased by 64% and 111%, respectively, from the second quarter of 2016. Sales decreased by 3% from the second quarter of 2016. Net average selling prices for paper were down from the second quarter of 2016 while net average selling prices for pulp were up. Our manufactured paper volumes were down while our pulp volumes were up when compared to the second quarter of 2016.

We paid \$26 million in dividends

HIGHLIGHTS FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2017

Operating income and net earnings increased by 86% and 164%, respectively, from the first half of 2016. Sales decreased by 1% from the first half of 2016. Net average selling prices for paper were down from the first half of 2016 while net average selling prices for pulp were flat. Our manufactured paper volumes were down while our pulp volumes were up when compared to the first half of 2016. Our Personal Care volumes were up, in part due to the acquisition of Home Delivery Incontinent Supplies (“HDIS”) on October 1, 2016.

A mechanical failure on the largest turbine generator at our Kamloops mill in the first quarter of 2017 negatively impacted our results by approximately \$3 million, net of insurance proceeds, in the first half of 2017.

We paid \$52 million in dividends

FINANCIAL HIGHLIGHTS (In millions of dollars, unless otherwise noted)	Three months ended					Six months ended				
			Variance					Variance		
	June 30, 2017	June 30, 2016	\$		%	June 30, 2017	June 30, 2016	\$		%
Sales	\$1,224	\$1,267	\$(43)	)	-3 %	\$2,528	\$2,554	\$(26)	)	-1 %
Operating income	64	39	25		64 %	106	57	49		86 %
Net earnings	38	18	20		111 %	58	22	36		164 %
Net earnings per common share										
(in dollars) ¹ :										
Basic	\$0.61	\$0.29	\$0.32		110 %	\$0.93	\$0.35	\$0.58		166 %
Diluted	\$0.61	\$0.29	\$0.32		110 %	\$0.93	\$0.35	\$0.58		166 %
								At June 30, 2017	At December 31, 2016	
Total assets								\$5,667	\$ 5,680	
Total long-term debt, including current										
portion								\$1,204	\$ 1,281	

See Note 4 “Earnings per Common Share” of the financial statements in this Quarterly Report on Form 10-Q for more information on the calculation of net earnings per common share.

OUTLOOK

For the remainder of the year, we expect our paper shipments to be in-line with market demand. Our pulp shipments should be higher due to the ramp-up of the Ashdown fluff pulp line, while mix should continue to improve as we convert more volume to fluff pulp. In Personal Care, investments in advertising and promotion in addition to new customer wins should drive higher sales, while raw material costs are expected to increase marginally.

CONSOLIDATED RESULTS OF OPERATIONS AND SEGMENT REVIEW

This section presents a discussion and analysis of our second quarter and first half of 2017 and 2016 sales, operating income (loss) and other information relevant to the understanding of our results of operations.

ANALYSIS OF SALES

By Business Segment	Three months ended				Six months ended			
			Variance				Variance	
	June 30, 2017	June 30, 2016	\$	%	June 30, 2017	June 30, 2016	\$	%
Pulp and Paper	\$999	\$1,054	(55)	-5%	\$2,072	\$2,139	(67)	-3%
Personal Care	241	228	13	6%	490	444	46	10%
Total for reportable segments	1,240	1,282	(42)	-3%	2,562	2,583	(21)	-1%
Intersegment sales	(16)	(15)	(1)		(34)	(29)	(5)	
Consolidated	1,224	1,267	(43)	-3%	2,528	2,554	(26)	-1%

Shipments

Paper - manufactured (in thousands of ST)	698	752	(54)	-7%	1,443	1,538	(95)	-6%
Communication Papers	582	627	(45)	-7%	1,204	1,284	(80)	-6%
Specialty and Packaging	116	125	(9)	-7%	239	254	(15)	-6%
Paper - sourced from third parties (in thousands of ST)	26	29	(3)	-10%	55	61	(6)	-10%
Paper - total (in thousands of ST)	724	781	(57)	-7%	1,498	1,599	(101)	-6%
Pulp (in thousands of ADMT)	383	360	23	6%	836	729	107	15%

ANALYSIS OF CHANGES IN SALES

	Second quarter of 2017 versus Second quarter of 2016 % Change in Sales due to							First half of 2017 versus First half of 2016 % Change in Sales due to						
	Net			Volume				Net			Volume			
	Price	/ Mix		Currency	Total			Price	/ Mix		Currency	Total		
Pulp and Paper	-1 %	-4	%	-	%	-5	%	-1 %	-2	%	-	%	-3	%
Personal Care	-1 %	9	% _(a)	-2	%	6	%	-2 %	14	% _(a)	-2	%	10	%
Consolidated sales	-1 %	-2	%	-	%	-3	%	-2 %	1	%	-	%	-1	%

Commentary:

(a) Includes sales of HDIS acquired on October 1, 2016.

ANALYSIS OF OPERATING INCOME (LOSS)

By Business Segment	Three months ended				Six months ended			
			Variance				Variance	
	June 30, 2017	June 30, 2016	\$	%	June 30, 2017	June 30, 2016	\$	%
Operating income (loss)								
Pulp and Paper	65	35	30	86 %	99	54	45	83 %
Personal Care	13	15	(2)	-13 %	29	29	-	- %
Corporate	(14)	(11)	(3)	-27 %	(22)	(26)	4	15 %
Consolidated operating income (loss)	64	39	25	64 %	106	57	49	86 %

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Second quarter of 2017 versus Second quarter of 2016

\$ Change in Segmented Operating Income (Loss) due to

	Volume	Net Price	Input Costs (b)	Operating Expenses (c)	Currency	Depreciation/Impairment (d)	Restructuring	Other Operating Income/Expense (f)	Total
Pulp and Paper	(10)	(10)	8	—	11	11	21	(1)	30
Personal Care	2	(a) (4)	2	(2)	—	—	—	—	(2)
Corporate	—	—	—	(2)	—	—	—	(1)	(3)
Consolidated operating income (loss)	(8)	(14)	10	(4)	11	11	21	(2)	25

(a) Includes results of HDIS acquired on October 1, 2016.

(b) Includes raw materials (such as fiber, chemicals, nonwovens and super absorbent polymers) and energy expenses.

(c) Includes maintenance, freight costs, selling, general and administrative (“SG&A”) expenses and other costs.

(d) In the second quarter of 2017, we did not record any accelerated depreciation compared to \$3 million of accelerated depreciation related to the conversion of a paper machine to a high quality fluff pulp line at our Ashdown mill, in the second quarter of 2016. Depreciation charges were lower by \$8 million in the second quarter of 2017, excluding foreign currency impact.

(e) In the second quarter of 2017, there were no restructuring charges. In the second quarter of 2016, we incurred restructuring charges of \$21 million related to the conversion at Ashdown described above.

(f)

Second quarter of 2017 other operating income/ Second quarter of 2016 other operating income/

expense includes:

- Environmental provision (\$2 million)

- Bad debt expense (\$1 million)

- Other income (\$1 million)

expense includes:

- Litigation settlement (\$2 million)

- Other income (\$2 million)

Commentary – Second quarter of 2017 compared to Second quarter of 2016

Interest Expense, net

We incurred \$17 million of net interest expense in the second quarter of 2017, an increase of \$2 million compared to net interest expense of \$15 million in the second quarter of 2016. This increase was mostly due to a reduction in capitalized interest and an increase in interest expense related to the Term Loan Agreement and was partially offset by the maturity of the 9.5% Notes due in August 2016 and of the 10.75% Notes due in June 2017.

Income Taxes

In the second quarter of 2017, our income tax expense was \$9 million, consisting of current income tax expense of \$17 million and a deferred income tax benefit of \$8 million. This compares to an income tax expense of \$6 million in the second quarter of 2016, consisting of a current income tax expense of \$8 million and a deferred income tax benefit of \$2 million. We made income tax payments, net of refunds, of \$23 million during the second quarter of 2017. Our

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effective tax rate was 19% compared with an effective tax rate of 25% in the second quarter of 2016. The effective tax rate for the second quarter of 2017 was favorably impacted by enacted law changes in several U.S. states and by the recognition of additional tax credits associated with the filing of certain 2016 income tax returns.

First half of 2017 versus First
half of 2016

\$ Change in Segmented Operating Income (Loss) due to

	Volume	Price	Input Costs (b)	Operating Expenses (c)	Currency	Depreciation/ Impairment (d)	Restructuring Expense (e)	Other Operating Income/ Expense (f)	Total
Pulp and Paper	(19)	(32)	14	(1)	16	42	23	2	45
Personal Care	7 (a)	(7)	7	(5)	(2)	—	—	—	—
Corporate	—	—	—	3	—	—	—	1	4
Consolidated operating income (loss)	(12)	(39)	21	(3)	14	42	23	3	49

- (a) Includes results of HDIS acquired on October 1, 2016.
- (b) Includes raw materials (such as fiber, chemicals, nonwovens and super absorbent polymers) and energy expenses.
- (c) Includes maintenance, freight costs, selling, general and administrative (“SG&A”) expenses and other costs.
- (d) In the first half of 2017, we did not record any accelerated depreciation compared to \$24 million of accelerated depreciation related to the conversion of a paper machine to a high quality fluff pulp line at our Ashdown mill, recorded in the first half of 2016. Depreciation charges were lower by \$18 million in the first half of 2017, excluding foreign currency impact.
- (e) In the first half of 2017, there were no restructuring charges. In the first half of 2016, we incurred restructuring charges of \$23 million mostly related to the conversion at Ashdown described above.
- (f)

First half of 2017 other operating income/

First half of 2016 other operating income/

expense includes:

expense includes:

- Environmental provision (\$2 million)

- Foreign currency loss on working capital items (\$4 million)

- Foreign currency loss on working capital items (\$1 million)

- Litigation settlement (\$2 million)

- Other income (\$2 million)

- Bad debt expense (\$1 million)

- Other income (\$3 million)

Commentary – First half of 2017 compared to first half of 2016

Interest Expense, net

We incurred \$34 million of net interest expense in the first half of 2017, an increase of \$2 million compared to net interest expense of \$32 million in the first half of 2016. This increase was mostly due to a reduction in capitalized interest and an increase in interest expense related to the Term Loan Agreement. This increase was partially offset by the maturity of the 9.5% Notes due in August 2016 and of the maturity of the 10.75% Notes due in June 2017.

Income Taxes

In the first half of 2017, our income tax expense was \$14 million, consisting of current income tax expense of \$26 million and a deferred income tax benefit of \$12 million. This compares to an income tax expense of \$3 million in the first half of 2016, consisting of a current income tax expense of \$8 million and a deferred income tax benefit of \$5 million. We made income tax payments, net of refunds, of \$15 million during the first half of 2017. Our effective tax rate was 19% compared to an effective tax rate of 12% in the first half of 2016. The effective tax rate for the first half of 2017 was favorably impacted by the recognition of previously unrecognized tax benefits due to a statute expiration in a foreign jurisdiction and also a U.S. state tax audit finalization, enacted law changes in several U.S. states, and the recognition of additional tax credits associated with the filing of certain 2016 income tax returns. The effective tax rate for the first half of 2016 was impacted by the approval of a state tax credit in the U.S.

Commentary – Segment Review

Pulp and Paper Segment

Sales in our Pulp and Paper segment decreased by \$55 million, or 5% when compared to sales in the second quarter of 2016. This decrease in sales is mostly due to a 1% decrease in net average selling prices, mostly due to a decrease in our net average selling price for paper, as well as a decrease in our paper sales volumes. This decrease was partially offset by an increase in our pulp sales volume.

Operating income in our Pulp and Paper segment amounted to \$65 million in the second quarter of 2017, an increase of \$30 million, when compared to operating income of \$35 million in the second quarter of 2016. Our results were positively impacted by:

- Lower restructuring costs mostly related to the conversion of a paper machine to a high quality fluff pulp line at our Ashdown mill, recorded in the second quarter of 2016 (\$21 million)
- Lower depreciation charges (\$11 million) due to accelerated depreciation related to our 2014 decision to convert a paper machine at our Ashdown facility to a high quality fluff pulp line in the second quarter of 2016 and lower depreciation charges due to certain assets being fully depreciated
- Positive impact of a weaker Canadian dollar on our Canadian denominated expenses as well as from our hedging program (\$11 million)
- Lower input costs (\$8 million) mostly related to lower fiber costs as a result of improved yields and lower energy costs, partially offset by higher chemicals costs

This increase was partially offset by:

- Lower average selling prices for paper partially offset by higher average selling prices for pulp (\$10 million)

Lower volume/ mix (\$10 million) mostly related to lower volume of paper, partially offset by higher volume of pulp

Higher other operating income/expense (\$1 million)

Sales in our Pulp and Paper segment decreased by \$67 million, or 3% when compared to sales in the first half of 2016.

This decrease in sales is mostly due to a 1% decrease in net average selling prices for paper as well as a decrease in our paper sales volumes. This decrease was partially offset by an increase in our pulp sales volumes.

Operating income in our Pulp and Paper segment amounted to \$99 million in the first half of 2017, an increase of \$45 million, when compared to operating income of \$54 million in the first half of 2016. Our results were positively impacted by:

Lower depreciation charges (\$42 million) due to accelerated depreciation related to our 2014 decision to convert a paper machine at our Ashdown facility to a high quality fluff pulp line in the first half of 2016 and lower depreciation charges due to certain assets being fully depreciated

Lower restructuring costs mostly related to the conversion of a paper machine to a high quality fluff pulp line at our Ashdown mill, recorded in the second quarter of 2016 (\$23 million)

Positive impact of our hedging program as well as a weaker Canadian dollar on our Canadian denominated expenses (\$16 million)

Lower input costs (\$14 million) mostly related to lower fiber costs as a result of improved yields and better weather and lower energy costs, partially offset by higher chemicals costs

Lower other operating income/expense (\$2 million)

This increase was partially offset by:

Lower average selling prices for paper while average selling prices for pulp were stable (\$32 million)

Lower volume/ mix (\$19 million) mostly related to lower volume of paper, partially offset by higher volume of pulp

Higher operating expenses (\$1 million)

The markets in which our pulp and paper business operate are highly competitive with well-established domestic and foreign manufacturers. In uncoated freesheet, we compete primarily on the basis of product quality, breadth of offering, service solutions and competitively priced paper products. We also compete with electronic transmission and document storage alternatives. As a result of such competition, we are experiencing ongoing decreasing demand for most of our existing paper products. Most of our products offering are commodities that are widely available from other producers as well. Because commodity products have few distinguishing qualities from producer to producer, competition for these products is based primarily on price, which is determined by supply relative to demand.

The pulp market is highly fragmented with many manufacturers competing worldwide. Competition is primarily on the basis of access to low-cost wood fiber, product quality and competitively priced pulp products.

For the remainder of the year, we expect our paper shipments to be in-line with market demand. Our pulp shipments should be higher due to the ramp-up of the Ashdown fluff pulp line, while mix should continue to improve as we convert more volume to fluff pulp.

Personal Care Segment

Sales in our Personal Care segment increased by \$13 million, or 6% when compared to sales in the second quarter of 2016. This increase in sales was driven by higher sales volume/mix of 9% mostly due to the acquisition of HDIS on October 1, 2016. This increase was partially offset by lower selling prices of 1% and unfavorable foreign currency rates of 2% due to the fluctuation between European currencies.

Operating income decreased by \$2 million or 13% in the second quarter of 2017 compared to the second quarter of 2016. Our results were negatively impacted by:

- Unfavorable average net selling prices (\$4 million)

- Higher operating expenses (\$2 million) mostly due to higher salaries and wages and higher selling, general and administrative expenses

This decrease was partially offset by:

- Higher sales volume and mix (\$2 million) in part due to the inclusion of HDIS as a result of the acquisition on October 1, 2016

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Lower input costs (\$2 million) mostly due to favorable pricing as a result of lower negotiated contract pricing as well as insourcing initiatives

Sales in our Personal Care segment increased by \$46 million, or 10% when compared to sales in the first half of 2016. This increase in sales was driven by higher sales volume/mix of 14%, partially offset by lower selling prices of 2% and unfavorable foreign currency rates of 2% due to fluctuations between European currencies.

Operating income remained stable in the first half of 2017 when compared to the first half of 2016.

Our results were negatively impacted by:

Unfavorable average net selling prices (\$7 million)

Higher operating expenses (\$5 million) mostly due to higher salaries and wages and higher selling, general and administrative expenses

Unfavorable foreign exchange mostly between the GBP and the Euro and the U.S. Dollar and Euro, net of our hedging program (\$2 million)

This decrease was offset by:

Higher sales volume and mix (\$7 million)

Lower input costs (\$7 million) mostly due to favorable pricing as a result of lower negotiated contract pricing as well as insourcing initiatives

In our absorbent hygiene products business, we compete in an industry with fundamental drivers for long-term growth. While we are expected to benefit from the overall increase in healthcare spending due to an aging population, it is not clear how recent administrative changes in the various national governments may impact the source of the funding. Changes in the balance of public versus private funding may be forthcoming and these could impact overall consumption or the channels in which consumption occurs. The principal methods and elements of competition include brand recognition and loyalty, product innovation, quality and performance, price and marketing and distribution capabilities.

For the remainder of the year, we expect investments in advertising and promotion. New customer wins should drive higher sales, while raw material costs are expected to increase marginally.

STOCK-BASED COMPENSATION EXPENSE

For the first half of 2017, stock-based compensation expense recognized in our results of operations was \$7 million for all outstanding awards which includes the mark-to-market recovery related to liability awards of \$2 million. This compares to a stock-based compensation expense of \$6 million for all outstanding awards which includes the mark-to-market recovery related to liability awards of \$3 million in the first half of 2016. Compensation costs for performance awards are based on management's best estimate of the final performance measurement.

LIQUIDITY AND CAPITAL RESOURCES

Our principal cash requirements are for ongoing operating costs, pension contributions, working capital and capital expenditures, as well as principal and interest payments on our debt and income tax payments. We expect to fund our liquidity needs primarily with internally generated funds from our operations and, to the extent necessary, through borrowings under our contractually committed \$700 million credit facility, of which \$680 million is currently undrawn and available, or through our \$150 million receivables securitization facility, of which \$11 million is currently undrawn and available. Under adverse market conditions, there can be no assurance that these agreements

would be available or sufficient. See “Capital Resources” below.

Our ability to make payments on the requirements mentioned above will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Our credit and receivable securitization facilities and debt indentures impose various restrictions and covenants on us that could limit our ability to respond to market conditions, to provide for unanticipated capital investments or to take advantage of business opportunities.

A portion of our cash is held outside the U.S. by foreign subsidiaries. The earnings of the foreign subsidiaries, which reflect full provision for local income taxes, are currently indefinitely reinvested in foreign operations. We do not intend on repatriating those

funds and no provision is made for income taxes that would be payable upon the distribution of earnings from foreign subsidiaries as computation of these amounts is not practical.

Operating Activities

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

Cash flows from operating activities totaled \$212 million in the first half of 2017, a \$3 million decrease compared to cash flows from operating activities of \$215 million in the first half of 2016. This decrease in cash flows provided from operating activities is primarily due to an increase in working capital requirements in the first half of 2017 when compared to the first half of 2016, partially offset by an increase in profitability (excluding the non-cash impairment charge of \$24 million in the first half of 2016). We made income tax payments, net of refunds of \$15 million in the first half of 2017 compared to income tax payments, net of refunds of \$27 million during the first half of 2016.

Investing Activities

Cash flows used for investing activities in the first half of 2017 amounted to \$71 million, a \$149 million decrease compared to cash flows used for investing activities of \$220 million in the first half of 2016.

The use of cash in the first half of 2017 was attributable to additions to property, plant and equipment of \$71 million.

The use of cash in the first half of 2016 was attributable to additions to property, plant and equipment of \$219 million.

Our capital expenditures for 2017 are expected to be approximately between \$210 million and \$230 million.

Financing Activities

Cash flows used for financing activities totaled \$148 million in the first half of 2017 compared to cash flows used for financing activities of \$11 million in the first half of 2016.

The use of cash in the first half of 2017 was primarily the result of dividend payments (\$52 million), the net repayments of borrowings under our credit facilities (revolver and receivable securitization) and long-term debt (\$83 million) and a decrease in our bank indebtedness (\$12 million).

The use of cash in the first half of 2016 was primarily the result of dividend payments (\$50 million), the repurchase of our common stock (\$10 million) and the repayment of long-term debt (\$1 million). These were partially offset by the net proceeds from borrowings under our credit facilities (revolver and receivable securitization) (\$50 million) and an increase in our bank indebtedness (\$1 million).

Capital Resources

Net indebtedness, consisting of bank indebtedness and long-term debt, net of cash and cash equivalents, was \$1,080 million as of June 30, 2017 compared to \$1,168 million as of December 31, 2016.

Notes Maturity

Our 9.5% Notes, in aggregate principal amount of \$39 million, matured on August 1, 2016.

Our 10.75% Notes, in aggregate principal amount of \$63 million, matured on June 1, 2017.

Term Loan

In the third quarter of 2015, a wholly owned subsidiary of Domtar borrowed \$300 million under an unsecured 10-year Term Loan Agreement that matures on July 20, 2025, with certain domestic banks. The facility was fully drawn down on August 19, 2015. The Company and certain significant domestic subsidiaries of the Company unconditionally guarantee any obligations from time to time arising under the Term Loan Agreement. On August 18, 2016, Domtar entered into an amendment to its Term Loan Agreement, pursuant to which, among other things, certain insignificant subsidiaries were released from their guarantees of the borrower's obligations under the Term Loan Agreement.

Borrowings under the Term Loan Agreement bear interest at LIBOR plus a margin of 1.875%. The Term Loan Agreement contains customary covenants, including two financial covenants: (i) an interest coverage ratio, as defined in the Term Loan Agreement, that

must be maintained at a level of not less than 3 to 1 and (ii) a leverage ratio, as defined in the Term Loan Agreement that must be maintained at a level of not greater than 3.75 to 1. At June 30, 2017, we were in compliance with these financial covenants.

Revolving Credit Facility

In August 2016, we amended and restated our unsecured revolving credit facility (the “Credit Agreement”) with certain domestic and foreign banks, increasing the amount available from \$600 million to \$700 million and extending the Credit Agreement’s maturity date from October 3, 2019 to August 18, 2021. The amendment also allows certain foreign subsidiaries to be borrowers under the facility. The maturity date of the facility may be extended by one year and the lender commitments may be increased by up to \$400 million, subject to lender approval and customary requirements.

Borrowings by the Company under the Credit Agreement are guaranteed by our significant domestic subsidiaries. Borrowings by foreign borrowers under the Credit Agreement are guaranteed by the Company, our significant domestic subsidiaries and certain of our foreign significant subsidiaries. The amendment allowed certain insignificant domestic subsidiaries that were previously guarantors, to be released from their guarantees of any obligations under the credit facility.

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

The Credit Agreement contains customary covenants and events of default for transactions of this type, including two financial covenants: (i) an interest coverage ratio, as defined in the Credit Agreement, that must be maintained at a level of not less than 3 to 1 and (ii) a leverage ratio, as defined in the Credit Agreement that must be maintained at a level of not greater than 3.75 to 1 (or 4.00 to 1 upon the occurrence of certain qualifying material acquisitions). At June 30, 2017, we were in compliance with these financial covenants. At June 30, 2017, we had \$20 million of borrowing (June 30, 2016— nil) and no outstanding letters of credit (June 30, 2016 – nil), leaving \$680 million unused and available under this facility.

Receivables Securitization

We have a \$150 million receivables securitization facility that matures in March 2019.

At June 30, 2017, borrowings under the receivables securitization facility amounted to \$80 million and \$59 million of letters of credit were issued under the program (June 30, 2016 – \$100 million and \$38 million, respectively). The program contains certain termination events, which include, but are not limited to, matters related to receivable performance, certain defaults occurring under the credit facility or our failure to repay or satisfy material obligations. At June 30, 2017, we had \$11 million unused and available under this facility.

Common Stock

On February 21, 2017 and May 3, 2017, our Board of Directors approved a quarterly dividend of \$0.415 per share, respectively, to be paid to holders of our common stock. Dividends of \$26 million were paid on April 17, 2017 and July 17, 2017, respectively, to shareholders of record on April 3, 2017 and July 3, 2017, respectively.

On August 1, 2017, our Board of Directors approved a quarterly dividend of \$0.415 per share to be paid to holders of our common stock. This dividend is to be paid on October 16, 2017, to shareholders of record on October 2, 2017.

OFF BALANCE SHEET ARRANGEMENTS

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

GUARANTEES

Indemnifications

In the normal course of business, we offer indemnifications relating to the sale of our businesses and real estate. In general, these indemnifications may relate to claims from past business operations, the failure to abide by covenants and the breach of representations and warranties included in sales agreements. Typically, such representations and warranties relate to taxation, environmental, product and employee matters. The terms of these indemnification agreements are generally for an unlimited period of time. At June 30, 2017, we were unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provision has been recorded. These indemnifications have not yielded significant expenses in the past.

Pension Plans

We have indemnified and held harmless the trustees of our pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions from us or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. At June 30, 2017, we have not recorded a liability associated with these indemnifications, as we do not expect to make any payments pertaining to these indemnifications.

RECENT ACCOUNTING PRONOUNCEMENTS

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

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

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

There has not been any material change to our policies since December 31, 2016. For more details on critical accounting policies, refer to our Annual Report on Form 10-K for the year ended December 31, 2016.

FORWARD-LOOKING STATEMENTS

The information included in this Quarterly Report on Form 10-Q, contains 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” 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:

- continued decline in usage of fine paper products in our core North American market;
- our ability to implement our business diversification initiatives, including strategic acquisitions;
- product selling prices;

- raw material prices, including fiber, chemical and energy;
- conditions in the global capital and credit markets, and the economy generally, particularly in the U.S., Canada and Europe;
- performance of Domtar Corporation's manufacturing operations, including unexpected maintenance requirements;
- the level of competition from domestic and foreign producers;
- the effect of, or change in, forestry, land use, environmental and other governmental regulations (including 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;

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legal proceedings;
changes in asset valuations, including impairment of property, plant and equipment, inventory, accounts receivable or other assets for impairment or other reasons;
changes in currency exchange rates, particularly the relative value of the U.S. dollar to the Canadian dollar and European currencies;
the effect of timing of retirements and changes in the market price of Domtar Corporation's common stock on charges for stock-based compensation;
performance of pension fund investments and related derivatives, if any; and
the other factors described under "Risk Factors", in item 1A of our Annual Report on Form 10-K, for the year ended December 31, 2016.

You are cautioned not to unduly rely on such forward-looking statements, which speak only as of the date made, when evaluating the information presented in this Quarterly Report on Form 10-Q. Unless specifically required by law, Domtar Corporation disclaims any obligation to update or revise these forward-looking statements to reflect new events or circumstances.

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, 2016. There have been no material changes in our exposure to market risk since December 31, 2016. A full discussion on Quantitative and Qualitative Disclosure about Market Risk, is found in Note 3 "Derivatives and Hedging Activities and Fair Value Measurement," of the financial statements in this Quarterly Report on Form 10-Q.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities and Exchange Act of 1934, as amended ("Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. As of June 30, 2017, 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, 2017, our disclosure controls and procedures were effective.

Change in Internal Control over Financial Reporting

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

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 14 “Commitments and Contingencies” of the financial statements in this Quarterly Report on Form 10-Q for the discussion regarding legal proceedings.

For a description of previously reported legal proceedings refer to Part I, Item 3, “Legal Proceedings,” of our Annual Report on Form 10-K for the year ended December 31, 2016.

ITEM 1A. RISK FACTORS

Our Annual Report on Form 10-K for the year ended December 31, 2016, contains important risk factors that could cause our actual results to differ materially from those projected in any forward-looking statement. There have been no material changes from the risk factors described in our Annual Report on Form 10-K for the year ended December 31, 2016.

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

During the second quarter and the first half of 2017, we did not repurchase any shares under our stock repurchase program (the “Program”). We currently have \$323 million of remaining availability under our Program. The Program may be suspended, modified or discontinued at any time and we have no obligation to repurchase any amount of our common stock under the Program. The Program has no set expiration date. We repurchase our common stock, from time to time, in part to reduce the dilutive effects of our stock options and awards and to improve shareholders’ returns. The timing and amount of stock repurchases will depend on a variety of factors, including market conditions, availability under the program as well as corporate and regulatory considerations. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Exhibit		Incorporated by reference to:		
Number	Exhibit Description	Form	Exhibit	Filing Date
10.1*	Amended and Restated DB SERP for Management Committee Members of Domtar			
10.2*	Amended and Restated DC SERP for Designated Executives of Domtar			
10.3*	Amended and Restated Supplementary Pension Plan for Designated Managers of Domtar Inc.			
10.4*	Amended and Restated DC SERP for Designated Executives of Domtar Personal Care			
10.5*	Amended and Restated Domtar Corporation 2007 Omnibus	DEF14A	Annex B	03/31/2017

Incentive Plan

10.6*	Domtar Corporation Annual Incentive Plan for Members of the Management Committee	DEF14A Annex A 03/31/2017
12.1	Computation of Ratio of Earnings to Fixed Charges	
31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
32.1	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
32.2	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley	

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Act of 2002

101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Extension Presentation Linkbase

* Indicates management contract of compensatory arrangement

SIGNATURE

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

DOMTAR CORPORATION

Date: August 4, 2017

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

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