

Domtar CORP  
Form 10-Q  
November 01, 2013  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2013**

**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)

Edgar Filing: Domtar CORP - Form 10-Q

**DELAWARE** **20-5901152**  
(State of Incorporation) (I.R.S. Employer Identification No.)  
**395 de Maisonneuve West, Montreal, Quebec H3A 1L6 Canada**

(Address of principal executive offices) (zip code)

**(514) 848-5555**

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

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

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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

At October 30, 2013, 31,814,270 shares of the issuer's voting common stock were outstanding.

**Table of Contents**

**DOMTAR CORPORATION**

**FORM 10-Q**

**For the Quarterly Period Ended September 30, 2013**

**INDEX**

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

CONSOLIDATED BALANCE SHEETS

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

CONSOLIDATED STATEMENTS OF CASH FLOWS

INDEX FOR NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

ITEM 1A. RISK FACTORS

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

ITEM 3. DEFAULT UPON SENIOR SECURITIES

ITEM 4. MINE SAFETY DISCLOSURES

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS

**Table of Contents****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)**

	For the three months ended		For the nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	(Unaudited)			
	\$	\$	\$	\$
<b>Sales</b>	<b>1,375</b>	<b>1,389</b>	<b>4,032</b>	<b>4,155</b>
<b>Operating expenses</b>				
Cost of sales, excluding depreciation and amortization	<b>1,116</b>	1,100	<b>3,280</b>	3,263
Depreciation and amortization	<b>93</b>	96	<b>281</b>	289
Selling, general and administrative	<b>95</b>	80	<b>281</b>	268
Impairment and write-down of property, plant and equipment (NOTE 12)			<b>15</b>	2
Closure and restructuring costs (NOTE 12)		2	<b>18</b>	3
Other operating loss, net (NOTE 7)	<b>22</b>	2	<b>89</b>	6
	<b>1,326</b>	1,280	<b>3,964</b>	3,831
<b>Operating income</b>	<b>49</b>	109	<b>68</b>	324
Interest expense, net	<b>21</b>	20	<b>67</b>	109
<b>Earnings before income taxes and equity loss</b>	<b>28</b>	89	<b>1</b>	215
Income tax expense (benefit)	<b>1</b>	22	<b>(26)</b>	57
Equity loss, net of taxes		1	<b>1</b>	5
<b>Net earnings</b>	<b>27</b>	66	<b>26</b>	153
Per common share (in dollars) (NOTE 5)				
<b>Net earnings</b>				
Basic	<b>0.83</b>	1.85	<b>0.77</b>	4.21
Diluted	<b>0.82</b>	1.84	<b>0.77</b>	4.20
Weighted average number of common and exchangeable shares outstanding (millions)				
Basic	<b>32.7</b>	35.7	<b>33.6</b>	36.3
Diluted	<b>32.8</b>	35.8	<b>33.7</b>	36.4
<b>Net earnings</b>	<b>27</b>	66	<b>26</b>	153
<b>Other comprehensive income (loss) (NOTE 14):</b>				
Net derivative gains (losses) on cash flow hedges:				
Net gains (losses) arising during the period, net of tax of \$2 and \$(3), respectively (2012 \$2 and \$2, respectively)	<b>2</b>	6	<b>(6)</b>	6
Less: Reclassification adjustment for gains included in net earnings, net of tax of \$(1) and \$(2), respectively (2012 \$1 and \$4, respectively)	<b>2</b>	2	<b>3</b>	7
Foreign currency translation adjustments	<b>33</b>	47	<b>(27)</b>	32
	<b>18</b>	(5)	<b>39</b>	(5)

## Edgar Filing: Domtar CORP - Form 10-Q

Change in unrecognized gains (losses) and prior service cost related to pension and post-retirement benefit plans, net of tax of \$(9) and \$(17), respectively (2012 \$(3) and \$(3) respectively)

<b>Other comprehensive income</b>	<b>55</b>	<b>50</b>	<b>9</b>	<b>40</b>
<b>Comprehensive income</b>	<b>82</b>	<b>116</b>	<b>35</b>	<b>193</b>

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

**Table of Contents**

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

(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)

	September 30, 2013	At December 31, 2012
	\$	(Unaudited) \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	191	661
Receivables, less allowances of \$4 and \$4	583	562
Inventories (NOTE 9)	703	675
Prepaid expenses	31	24
Income and other taxes receivable	48	48
Deferred income taxes	58	45
<b>Total current assets</b>	<b>1,614</b>	<b>2,015</b>
Property, plant and equipment, at cost	8,928	8,793
Accumulated depreciation	(5,576)	(5,392)
<b>Net property, plant and equipment</b>	<b>3,352</b>	<b>3,401</b>
<b>Goodwill (NOTE 10)</b>	<b>367</b>	<b>263</b>
<b>Intangible assets, net of amortization (NOTE 11)</b>	<b>409</b>	<b>309</b>
<b>Other assets</b>	<b>143</b>	<b>135</b>
<b>Total assets</b>	<b>5,885</b>	<b>6,123</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Bank indebtedness	6	18
Trade and other payables	693	646
Income and other taxes payable	16	15
Long-term debt due within one year	6	79
<b>Total current liabilities</b>	<b>721</b>	<b>758</b>
<b>Long-term debt</b>	<b>1,102</b>	<b>1,128</b>
<b>Deferred income taxes and other</b>	<b>946</b>	<b>903</b>
<b>Other liabilities and deferred credits</b>	<b>435</b>	<b>457</b>
<b>Commitments and contingencies (NOTE 16)</b>		
<b>Shareholders' equity</b>		
Common stock		
\$0.01 par value; authorized 2,000,000,000 shares; issued: 42,551,774 and 42,523,896 shares		
Treasury stock (NOTE 15)		
\$0.01 par value; 10,742,472 and 8,285,292 shares		
Exchangeable shares		
No par value unlimited shares authorized; issued and held by nonaffiliates: 584,214 and 607,814 shares	46	48
Additional paid-in capital	1,998	2,175
Retained earnings	756	782
Accumulated other comprehensive loss	(119)	(128)

<b>Total shareholders' equity</b>	<b>2,681</b>	<b>2,877</b>
<b>Total liabilities and shareholders' equity</b>	<b>5,885</b>	<b>6,123</b>

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

**Table of Contents**

**DOMTAR CORPORATION**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

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

	Issued and outstanding common and exchangeable shares (millions of shares)	Exchangeable shares	Additional paid-in capital	Retained earnings (Unaudited)	Accumulated other comprehensive loss	Total shareholders equity
		\$	\$	\$	\$	\$
Balance at December 31, 2012	34.8	48	2,175	782	(128)	2,877
Conversion of exchangeable shares		(2)	2			
Stock-based compensation, net of tax			4			4
Net earnings				26		26
Net derivative losses on cash flow hedges:						
Net losses arising during the period, net of tax of \$(3)					(6)	(6)
Less: Reclassification adjustments for gains included in net earnings, net of tax of \$(2)					3	3
Foreign currency translation adjustments					(27)	(27)
Change in unrecognized gains and prior service cost related to pension and post retirement benefit plans, net of tax of \$(17)					39	39
Stock repurchase	(2.4)		(183)			(183)
Cash dividends				(52)		(52)
<b>Balance at September 30, 2013</b>	<b>32.4</b>	<b>46</b>	<b>1,998</b>	<b>756</b>	<b>(119)</b>	<b>2,681</b>

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



**Table of Contents**

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

	For the nine months ended September 30, 2013	September 30, 2012 (Unaudited)
	\$	\$
<b>Operating activities</b>		
Net earnings	26	153
Adjustments to reconcile net earnings to cash flows from operating activities		
Depreciation and amortization	281	289
Deferred income taxes and tax uncertainties	(9)	13
Impairment and write-down of property, plant and equipment and intangible assets	15	2
Net losses on disposals of property, plant and equipment and sale of business	9	
Stock-based compensation expense	4	3
Equity loss, net	1	5
Other	(4)	(11)
Changes in assets and liabilities, excluding the effects of acquisition and sale of businesses		
Receivables	(46)	(1)
Inventories	(19)	20
Prepaid expenses	(5)	(7)
Trade and other payables	15	(80)
Income and other taxes	(11)	6
Difference between employer pension and other post-retirement contributions and pension and other post-retirement expense	23	7
Other assets and other liabilities	7	12
Cash flows provided from operating activities	287	411
<b>Investing activities</b>		
Additions to property, plant and equipment	(180)	(171)
Proceeds from disposals of property, plant and equipment and sale of business	55	
Acquisition of businesses, net of cash acquired	(287)	(293)
Investment in joint venture	(1)	(5)
Cash flows used for investing activities	(413)	(469)
<b>Financing activities</b>		
Dividend payments	(50)	(42)
Net change in bank indebtedness	(13)	8
Issuance of long-term debt		548
Repayment of long-term debt	(99)	(190)
Stock repurchase	(183)	(116)
Other	2	(1)
Cash flows (used for) provided from financing activities	(343)	207
<b>Net (decrease) increase in cash and cash equivalents</b>	(469)	149
Impact of foreign exchange on cash	(1)	
Cash and cash equivalents at beginning of period	661	444

<b>Cash and cash equivalents at end of period</b>	<b>191</b>	<b>593</b>
<b>Supplemental cash flow information</b>		
Net cash payments for:		
Interest (including \$2 million and \$47 million of tender offer premiums in 2013 and 2012, respectively)	<b>60</b>	92
Income taxes (refund) paid	<b>(8)</b>	60

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

**Table of Contents**

**INDEX FOR NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1	<u>BASIS OF PRESENTATION</u>
NOTE 2	<u>RECENT ACCOUNTING PRONOUNCEMENTS</u>
NOTE 3	<u>ACQUISITION OF BUSINESSES</u>
NOTE 4	<u>DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT</u>
NOTE 5	<u>EARNINGS PER SHARE</u>
NOTE 6	<u>PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS</u>
NOTE 7	<u>OTHER OPERATING LOSS, NET</u>
NOTE 8	<u>INCOME TAXES</u>
NOTE 9	<u>INVENTORIES</u>
NOTE 10	<u>GOODWILL</u>
NOTE 11	<u>INTANGIBLE ASSETS, NET</u>
NOTE 12	<u>CLOSURE AND RESTRUCTURING COSTS AND LIABILITY AND IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT</u>
NOTE 13	<u>LONG-TERM DEBT</u>
NOTE 14	<u>CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT</u>
NOTE 15	<u>SHAREHOLDERS' EQUITY</u>
NOTE 16	<u>COMMITMENTS AND CONTINGENCIES</u>
NOTE 17	<u>SEGMENT DISCLOSURES</u>
NOTE 18	<u>SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION</u>
NOTE 19	<u>SALE OF ARIVA U.S.</u>

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

**(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 nine 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, 2012, as filed with the Securities and Exchange Commission. The December 31, 2012 Consolidated Balance Sheet, presented for comparative purposes in this interim report, was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

**ACCOUNTING CHANGES IMPLEMENTED**

**COMPREHENSIVE INCOME**

In February 2013, the FASB issued Accounting Standards Update (ASU) 2013-02, an update to Comprehensive Income, which requires an entity to provide information regarding the amounts reclassified out of accumulated other comprehensive income by component. The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source, and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, companies would instead cross reference to the related footnote for additional information. The Company adopted the new requirement on January 1, 2013 with no impact on the Company's consolidated financial statements except for the change in presentation.

The Company has chosen to present the new information as a separate disclosure in the notes to the consolidated financial statements.

**FUTURE ACCOUNTING CHANGES**

**FOREIGN CURRENCY MATTERS**

In March 2013, the FASB issued ASU 2013-05, an update to Foreign Currency Matters, which indicates that a cumulative translation adjustment is attached to the parent's investment in a foreign entity and should be released in a manner consistent with the derecognition guidance on investments in entities. Thus, the entire amount of the cumulative translation adjustment associated with the foreign entity would be released when there has been (i) a sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in the foreign entity; (ii) a loss of a controlling financial interest in an investment in a foreign entity; or (iii) a step acquisition for a foreign entity. The update does not change the requirement to release a pro-rata portion of the cumulative translation adjustment of the foreign entity into earnings for a partial sale of an equity method investment in a foreign entity.

The amendments are effective for interim and annual periods beginning after December 15, 2013 and will not have an impact on the Company's consolidated financial statements unless one or more of the derecognition events stated above occur after the effective date.

**INCOME TAXES**

In July 2013, the FASB issued ASU 2013-11, which provides guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 requires entities to present an unrecognized tax benefit as a reduction of a deferred tax asset for a NOL or tax credit carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. This accounting standard update requires entities to assess whether to net the unrecognized tax benefit with a deferred tax asset as of the reporting date. The amendments are effective for interim and annual periods beginning after December 15, 2013. Other than the change in the presentation, the Company has determined these changes will not have a material impact on the consolidated financial statements.



**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 3. ACQUISITION OF BUSINESSES***Acquisition of Associated Hygienic Products LLC*

On July 1, 2013, Domtar Corporation completed the acquisition of 100% of the outstanding shares of Associated Hygienic Products LLC ( AHP ). AHP manufactures and markets infant diapers in the United States. AHP has 599 employees and operates two manufacturing facilities, a 376,500 square foot manufacturing facility in Delaware, Ohio and a 312,500 square foot manufacturing facility in Waco, Texas. AHP also has administrative offices and operates a distribution center in Duluth, Georgia. The results of AHP's operations are included in the Personal Care reportable segment as of July 1, 2013. The purchase price was \$276 million in cash, including working capital, net of cash acquired of \$2 million. The acquisition was accounted for as a business combination under the acquisition method of accounting, in accordance with the Business Combinations Topic of FASB Accounting Standards Codification.

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

The table below illustrates the preliminary purchase price allocation:

<b>Fair value of net assets acquired at the date of acquisition</b>	
Receivables	26
Inventory	29
Property, plant and equipment	99
Intangible assets	
Customer relationships <sup>(1)</sup>	67
Licence rights <sup>(2)</sup>	29
	96
Goodwill	103
<b>Total assets</b>	<b>353</b>
<b>Less: Liabilities</b>	
Trade and other payables	37
Intangible lease liability	13
Deferred income tax liabilities	27
<b>Total liabilities</b>	<b>77</b>
<b>Fair value of net assets acquired at the date of acquisition</b>	<b>276</b>

<sup>(1)</sup> The preliminary useful life of the Customer relationships acquired is expected to be 20 years.

<sup>(2)</sup> The preliminary useful life of the License rights acquired is expected to be 12 years.

## Edgar Filing: Domtar CORP - Form 10-Q

Goodwill represent the future economic benefit arising from other assets acquired that could not be individually identified and separately recognized. The goodwill is attributable to the general reputation of the business, the assembled workforce, the expected synergies and the expected future cash flows of the business. Disclosed goodwill is not deductible for tax purposes. Pro forma results have not been provided, as this acquisition has no material impact on the Company.



**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 3. ACQUISITION OF BUSINESSES (CONTINUED)***Xerox*

On June 1, 2013, Domtar Corporation completed the acquisition of Xerox's paper and print media products assets in the United States and Canada. The transaction includes a broad range of coated and uncoated papers and specialty print media including business forms, carbonless as well as wide-format paper formerly distributed by Xerox. The results of this business are presented in the Pulp and Paper reportable segment. The purchase price was \$7 million in cash plus inventory on a dollar for dollar basis. The acquisition was accounted for as a business combination under the acquisition method of accounting, in accordance with the Business Combinations Topic of FASB Accounting Standards Codification.

The total purchase price was allocated to tangible and intangible assets acquired based on the Company's estimates of their fair value, which are based on information currently available. During the third quarter of 2013, the Company completed the evaluation of all assets and liabilities.

The table below illustrates the purchase price allocation:

Inventory	<b>4</b>
Intangible assets (Note 11)	
<i>Customer relationships</i> <sup>(1)</sup>	<i>1</i>
<i>License rights</i> <sup>(2)</sup>	<i>6</i>
	<b>7</b>
<b>Total assets</b>	<b>11</b>
<b>Fair value of assets acquired at the date of acquisition</b>	<b>11</b>

<sup>(1)</sup> The useful life of the Customer relationships acquired is expected to be 20 years.

<sup>(2)</sup> Indefinite useful life.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT**

**INTEREST RATE RISK**

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

**CREDIT RISK**

The Company is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, the Company reviews new customers' credit history before granting credit and conducts regular reviews of existing customers' credit performance. As at September 30, 2013, one of Domtar's Pulp and Paper segment customers located in the United States represented 13% (\$76 million) (2012 11% (\$64 million)) of the Company's receivables.

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

**COST RISK**

Cash flow hedges:

The Company purchases natural gas at the prevailing market price at the time of delivery. In order to manage the cash flow risk associated with purchases of natural gas, the Company may utilize derivative financial instruments or physical purchases to fix the price of forecasted natural gas purchases. The Company formally documents the hedge relationships, including identification of the hedging instruments and the hedged items, the risk management objectives and strategies for undertaking the hedge transactions, and the methodologies used to assess effectiveness and measure ineffectiveness. Current contracts are used to hedge a portion of forecasted purchases over the next 51 months. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded in Other comprehensive income, and is recognized in Cost of sales in the period in which the hedged transaction occurs.

**Table of Contents****DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2013****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)**

The following table presents the volumes under derivative financial instruments for natural gas contracts outstanding as of September 30, 2013 to hedge forecasted purchases:

Commodity	Notional contractual quantity under derivative contracts		Notional contractual value under derivative contracts (in millions of dollars)	Percentage of forecasted purchases under derivative contracts for			
				2013 <sup>(2)</sup>	2014	2015	2016
Natural gas	21,915,000	MMBTU <sup>(1)</sup>	\$ 91	32%	56%	31%	25%

<sup>(1)</sup> MMBTU: Millions of British thermal units

<sup>(2)</sup> Represents the remaining three months of 2013.

The natural gas derivative contracts were fully effective for hedge accounting purposes as of September 30, 2013. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings and Comprehensive Income for the three and nine months ended September 30, 2013 resulting from hedge ineffectiveness (three and nine months ended September 30, 2012 nil).

**FOREIGN CURRENCY RISK****Cash flow hedges:**

The Company has manufacturing operations in the United States, Canada, Sweden and China. As a result, it is exposed to movements in foreign currency exchange rates in Canada, Europe and Asia. Moreover, certain assets and liabilities are denominated in currencies other than the U.S. dollar and are exposed to foreign currency movements. As a result, the Company's earnings are affected by increases or decreases in the value of the Canadian dollar and of other European and Asian currencies relative to the U.S. dollar. The Company's Swedish subsidiary is exposed to movements in foreign currency exchange rates on transactions denominated in a currency other than its 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 instruments (currency options and foreign exchange forward contracts) to mitigate its exposure to fluctuations in foreign currency exchange rates or to designate them as hedging instruments in order to hedge the subsidiary's cash flow risk for purposes of the consolidated financial statements.

The Company formally documents the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking the hedge transactions. Foreign exchange currency option contracts used to hedge forecasted purchases in Canadian dollars by the Canadian subsidiary, and forecasted sales in British Pound Sterling and forecasted purchases in U.S. dollars by the Swedish subsidiary, are designated as cash flow hedges. Current contracts are used to hedge forecasted sales or purchases over the next 12 months. The effective portion of changes in the fair value of derivative contracts designated as cash flow hedges is recorded in Other

## Edgar Filing: Domtar CORP - Form 10-Q

comprehensive income and is recognized in Cost of sales or in Sales in the period in which the hedged transaction occurs.

### Net investment hedge:

The Company uses foreign exchange currency option contracts maturing in February 2014 to hedge a portion of the net assets of Attends Healthcare Limited ( Attends Europe ) to offset the foreign currency translation and economic exposures related to its investment in the subsidiary. The Company is exposed to movements in foreign currency exchange rates of the Euro versus the U.S. dollar as Attends Europe has a Euro functional currency whereas the Company has a U.S. dollar functional and reporting currency. The effective portion of changes in the fair value of derivative contracts designated as net investment hedges is recorded in Other comprehensive income as part of the Foreign currency translation adjustments.

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

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

The following table presents the currency values under contracts pursuant to currency options outstanding as of September 30, 2013 to hedge forecasted purchases and sales:

Contract		Notional contractual value	Percentage of forecasted net exposures under contracts for	
			2013	2014
Currency options purchased	CDN	\$ 425	50%	37%
	USD	\$ 26	69%	63%
	GBP	£ 16	89%	62%
Currency options sold	CDN	\$ 425	50%	37%
	USD	\$ 26	69%	63%
	GBP	£ 16	89%	62%

The currency options are fully effective as at September 30, 2013. The critical terms of the hedging instruments and the hedged items match. As a result, there were no amounts reflected in the Consolidated Statements of Earnings and Comprehensive Income for the three and nine months ended September 30, 2013 resulting from hedge ineffectiveness (three and nine months ended September 30, 2012 nil).

The notional amount of the outstanding foreign exchange currency option contracts not included in the table above, designated as a net investment hedge as of September 30, 2013 was \$142 million ( 105 million).

**Table of Contents****DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2013****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)****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.

The following tables present information about the Company's financial assets and financial liabilities measured at fair value on a recurring basis (except Long-term debt, see (c) below) at September 30, 2013 and December 31, 2012, in accordance with the accounting standards dealing with 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:**

Derivatives designated as cash flow and net investment hedging instruments under the Derivatives and Hedging Topic of FASB ASC:	Quoted prices in active markets for Significant unobservable				Balance sheet classification
	September 30, 2013	identical assets (Level 1)	observable inputs (Level 2)	significant unobservable inputs (Level 3)	
	\$	\$	\$	\$	
<b>Asset derivatives</b>					
Currency options	6		6		(a) Prepaid expenses
Natural gas swap contracts					(a) Prepaid expenses
Natural gas swap contracts					(a) Intangible assets and deferred charges
<b>Total Assets</b>	<b>6</b>		<b>6</b>		
<b>Liabilities derivatives</b>					
Currency options	6		6		(a) Trade and other payables
Natural gas swap contracts	2		2		(a) Trade and other payables

# Edgar Filing: Domtar CORP - Form 10-Q

Natural gas swap contracts	2	2	(a) Other liabilities and deferred credits
<b>Total Liabilities</b>	<b>10</b>	10	
<b>Other Instruments:</b>			
Asset backed notes ( ABN )	6	5	1 (b) Other assets
Long-term debt	1,206	1,206	(c) Long-term debt

The cumulative loss recorded in Accumulated other comprehensive loss relating to natural gas contracts of \$4 million at September 30, 2013, will be recognized in Cost of sales upon maturity of the derivatives over the next four years at the then prevailing values, which may be different from those at September 30, 2013.

The cumulative loss recorded in Accumulated other comprehensive loss relating to currency options hedging forecasted purchases of \$1 million at September 30, 2013, 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 September 30, 2013.

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 4. DERIVATIVES AND HEDGING ACTIVITIES AND FAIR VALUE MEASUREMENT (CONTINUED)****Fair Value of financial instruments at:**

Derivatives designated as cash flow and net investment hedging instruments under the Derivatives and Hedging Topic of FASB ASC:	December 31, 2012 \$	Quoted prices in active markets for identical assets (Level 1) \$	Significant observable inputs (Level 2) \$	Significant unobservable inputs (Level 3) \$	Balance sheet classification
<b>Asset derivatives</b>					
Currency options	6		6		(a) Prepaid expenses
Natural gas swap contracts	1		1		(a) Intangible assets and deferred charges
<b>Total Assets</b>	<b>7</b>		<b>7</b>		
<b>Liabilities derivatives</b>					
Currency options	5		5		(a) Trade and other payables
Natural gas swap contracts	4		4		(a) Trade and other payables
Natural gas swap contracts	1		1		(a) Other liabilities and deferred credits
<b>Total Liabilities</b>	<b>10</b>		<b>10</b>		
<b>Other Instruments:</b>					
Asset backed notes	6		5	1	(b) Other assets
Long-term debt	1,360	1,360			(c) Long-term debt

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

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



## Edgar Filing: Domtar CORP - Form 10-Q

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

- (b) ABN is reported at fair value utilizing Level 2 or Level 3 inputs. Fair value of ABN reported under Level 2 is based on current market quotes. Fair value of ABN reported under Level 3 is based on the value of the collateral investments held in the conduit issuer, reduced by the negative value of credit default derivatives, with an additional discount applied for illiquidity.
- (c) Fair value of the Company's long-term debt is measured by comparison to market prices of its debt. The carrying value of the Company's long-term debt is \$1,108 million and \$1,207 million at September 30, 2013 and December 31, 2012, 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.

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

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

The following table reconciles the beginning and ending balances of ABN measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the reported periods:

**ASSET BACKED NOTES**

<b>Balance at January 1, 2013</b>	<b>1</b>
Net unrealized gains included in earnings <sup>(a)</sup>	
Transfer out of Level 3 <sup>(b)</sup>	
<b>Balance at September 30, 2013</b>	<b>1</b>

(a) Earnings effect is primarily included in Other operating loss, net in the Consolidated Statement of Earnings and Comprehensive Income.

(b) Transfers out of Level 3 are considered to occur at the end of the period.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 5. EARNINGS PER SHARE**

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

	For the three months ended		For the nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Net earnings	\$ 27	\$ 66	\$ 26	\$ 153
Weighted average number of common and exchangeable shares outstanding (millions)	32.7	35.7	33.6	36.3
Effect of dilutive securities (millions)	0.1	0.1	0.1	0.1
Weighted average number of diluted common and exchangeable shares outstanding (millions)	32.8	35.8	33.7	36.4
Basic net earnings per share (in dollars)	\$0.83	\$1.85	\$0.77	\$4.21
Diluted net earnings per share (in dollars)	\$ 0.82	\$ 1.84	\$ 0.77	\$ 4.20

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

	For the three months ended		For the nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Restricted stock units		15,802		
Performance share units		1,808		
Options	221,892	177,970	221,892	84,625

**Table of Contents****DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2013****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 6. PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS****DEFINED CONTRIBUTION PLANS**

The Company has several defined contribution plans and multi-employer plans. The pension expense under these plans is equal to the Company's contribution. For the three and nine months ended September 30, 2013, the related pension expense was \$6 million and \$22 million, respectively (2012 \$4 million and \$19 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 that cover the majority of its employees. Non-unionized employees in Canada joining the Company after June 1, 2000 participate in a defined contribution pension plan. Salaried employees in the U.S. joining the Company after January 1, 2008 participate in a defined contribution pension plan. Also, starting on January 1, 2013, all unionized employees covered under the agreement with the United Steel Workers, not grandfathered under the existing defined benefit pension plans, will transition to 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 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 September 30, 2013		For the nine months ended September 30, 2013	
	Pension plans \$	Other post-retirement benefit plans \$	Pension plans \$	Other post-retirement benefit plans \$
Service cost	10	1	32	2
Interest expense	19	2	56	4
Expected return on plan assets	(24)		(72)	
Amortization of net actuarial loss	6		20	1
Curtailment loss	1		1	
Settlement loss (a)			13	
Amortization of prior year service costs	1		2	
<b>Net periodic benefit cost</b>	<b>13</b>	<b>3</b>	<b>52</b>	<b>7</b>

## Edgar Filing: Domtar CORP - Form 10-Q

- (a) The settlement loss of \$13 million in the pension plans for the nine months ended September 30, 2013 is related to the previously closed Big River and Dryden mills for \$6 million and \$7 million, respectively (see Note 12 Closure and restructuring and liability and impairment of property, plant and equipment ).

Table of Contents

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 6. PENSION PLANS AND OTHER POST-RETIREMENT BENEFIT PLANS (CONTINUED)**

	For the three months ended September 30, 2012		For the nine months ended September 30, 2012	
	Pension plans \$	Other post-retirement benefit plans \$	Pension plans \$	Other post-retirement benefit plans \$
Service cost	10		29	2
Interest expense	20	1	60	4
Expected return on plan assets	(23)		(69)	
Amortization of net actuarial loss	4	1	13	1
Curtailment gain (b)		(13)		(13)
Settlement loss				
Amortization of prior year service costs	1		3	(1)
<b>Net periodic benefit cost</b>	<b>12</b>	<b>(11)</b>	<b>36</b>	<b>(7)</b>

(b) The curtailment gain of \$13 million in the other post-retirement benefit plans for the nine months ended September 30, 2012, is as a result of the curtailment of benefits related to the majority of employees covered by the plan.

The Company contributed \$17 million and \$31 million for the three and nine months ended September 30, 2013, respectively (2012 \$10 million and \$29 million, respectively) to the pension plans. The Company also contributed \$2 million and \$5 million for the three and nine months ended September 30, 2013, respectively (2012 \$2 million and \$6 million, respectively) to the other post-retirement benefit plans.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 7. 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:

	Three months ended September 30, 2013 \$	September 30, 2012 \$	Nine months ended September 30, 2013 \$	September 30, 2012 \$
Reversal of alternative fuel tax credits (Note 8)			26	
Loss on sale of business <sup>(1)</sup> (Note 19)	19		19	
Gain on sale of property, plant and equipment <sup>(2)</sup>			(10)	
Environmental provision			2	2
Foreign exchange loss (gain)	1	1	(1)	3
Weston litigation <sup>(3)</sup> (Note 16)			49	
Other	2	1	4	1
Other operating loss, net	22	2	89	6

<sup>(1)</sup> On July 31, 2013, the Company completed the sale of its Ariva U.S. business. The transaction closed at the end of July 2013. The Company recorded a loss on sale of business of \$19 million in the third quarter of 2013 (see Note 19 – Sales of Ariva U.S. for further information).

<sup>(2)</sup> On March 22, 2013, the Company sold the building, remaining equipment and related land of the closed pulp and paper mill in Port Edwards, Wisconsin and recorded a gain on the sale of approximately \$10 million. The transaction included specific machinery, equipment, furniture, parts, supplies, tools, real estate, land improvements, and other fixed or tangible assets. The assets were sold as is for proceeds of approximately \$9 million and the environmental provision of \$3 million related to these assets was contractually passed on to the buyer and released from the Company's liabilities. The net book value of the assets sold was approximately \$2 million.

<sup>(3)</sup> On June 24, 2013, the parties agreed to settle the Weston litigation for a payment by Domtar to Weston of \$49 million (CDN \$50 million) (see Note 16 – Commitments and Contingencies for further information).

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 8. INCOME TAXES**

For the third quarter of 2013, the Company's income tax expense amounted to \$1 million, consisting of a current tax expense of \$10 million and a deferred tax benefit of \$9 million. This compares to an income tax expense of \$22 million in the third quarter of 2012, consisting of a current tax expense of \$17 million and a deferred tax expense of \$5 million. The Company made income tax payments, net of refunds, of \$1 million during the third quarter of 2013. The effective tax rate for the third quarter was 4% compared to an effective tax rate of 25% in the third quarter of 2012. The effective tax rate for the third quarter of 2013 was impacted by the recognition of additional tax benefits related to the finalization of certain estimates in connection with the filing of the Company's 2012 tax return, as well as by the benefit of enacted state and provincial tax law changes in North Carolina and British Columbia.

For the first nine months of 2013, the Company's income tax benefit amounted to \$26 million, consisting of a current tax benefit of \$17 million and a deferred tax benefit of \$9 million. This compares to an income tax expense of \$57 million in the first nine months of 2012, consisting of a current tax expense of \$44 million and a deferred tax expense of \$13 million. The Company received income tax refunds, net of payments, of \$8 million during the first nine months of 2013. The Company's effective tax rate for the first nine months of 2013 was negative compared to the effective tax rate of 27% for the first nine months of 2012. The tax benefit for the first nine months of 2013 was impacted by the conversion of \$26 million of Alternative Fuel Tax Credits from the 2009 tax year into \$55 million of Cellulosic Biofuel Producer Credits (\$33 million benefit after-tax) a reduction of unrecognized tax benefits of \$8 million related to this conversion, and the enacted tax changes in North Carolina and British Columbia. These tax benefits were partially offset by the \$49 million (CDN \$50 million) litigation settlement payment due to \$38 million (CDN \$39 million) being non-deductible for income tax purposes.

The Company's gross unrecognized tax benefits were reduced in the first nine months of 2013 by \$8 million for unrecognized tax benefits previously associated with Alternative Fuel Tax Credits from 2009 that were converted into Cellulosic Biofuel Producer Credits in the first quarter of 2013, partially offset by \$5 million of accrued interest.



**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 9. INVENTORIES**

The following table presents the components of inventories:

	September 30, 2013 \$	December 31, 2012 \$
Work in process and finished goods	398	381
Raw materials	118	112
Operating and maintenance supplies	187	182
	703	675

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 10. GOODWILL**

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

	September 30, 2013 \$
<b>Balance at December 31, 2012</b>	263
Acquisition of Associated Hygienic Products LLC	103
Effect of foreign currency exchange rate change	1
<b>Balance at end of period</b>	367

The goodwill at September 30, 2013 is entirely related to the Personal Care segment (see Note 3 – Acquisition of Businesses – for further information on the increase in 2013).

At September 30, 2013, the accumulated impairment loss amounts to \$321 million (2012 – \$321 million). The impairment of goodwill was done in 2008, and was related to the Pulp and Paper segment.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 11. INTANGIBLE ASSETS, NET**

The following table presents the components of intangible assets, net:

	Estimated useful lives (in years)	September 30, 2013			December 31, 2012		
		Gross carrying amount \$	Accumulated amortization \$	Net	Gross carrying amount \$	Accumulated amortization \$	Net
<b>Intangible assets subject to amortization</b>							
Water rights	40	8	(1)	7	8	(1)	7
Customer relationships	20 40	254	(11)	243	186	(9)	177
Trade names	7	7	(6)	1	7	(5)	2
Supplier agreement	5				6	(6)	
Technology	7 20	8	(1)	7	8		8
Non-Compete	9	1		1	1		1
License rights	12	29		29			
		<b>307</b>	<b>(19)</b>	<b>288</b>	<b>216</b>	<b>(21)</b>	<b>195</b>
<b>Intangible assets not subject to amortization</b>							
Trade names		115		115	114		114
License rights		6		6			
<b>Total</b>		<b>428</b>	<b>(19)</b>	<b>409</b>	<b>330</b>	<b>(21)</b>	<b>309</b>

Amortization expense related to intangible assets for the three and nine months ended September 30, 2013 was \$3 million and \$7 million, respectively (2012 \$2 million and \$6 million, respectively).

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

	2013 \$	2014 \$	2015 \$	2016 \$	2017 \$
Amortization expense related to intangible assets	10	13	12	12	12

---

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 12. CLOSURE AND RESTRUCTURING COSTS AND LIABILITY AND IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT**

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

In relation to the withdrawal from one of the Company's multiemployer pension plans in 2011, the Company recorded an additional charge to earnings of \$1 million due to a change in the estimated withdrawal liability during the first quarter of 2013. During the second quarter of 2013, the Company decided to withdraw from another of its multiemployer pension plans and recorded a withdrawal liability and a charge to earnings of \$3 million. At September 30, 2013, the total provision for the withdrawal liabilities is \$51 million. While this is the Company's best estimate of the ultimate cost of the withdrawal from these plans at September 30, 2013, additional withdrawal liabilities may be incurred based on the final fund assessment expected to occur in the fourth quarter of 2013. Further, the Company remains liable for potential additional withdrawal liabilities to the fund in the event of a mass withdrawal, as defined by statute, occurring anytime within the next three years.

During the second quarter of 2013, the Company also incurred pension settlement losses in the amount of \$13 million related to the previously closed Big River sawmill and Dryden paper mill for \$6 million and \$7 million, respectively.

*Ariva U.S.*

On July 31, 2013, the Company completed the sale of its Ariva business in the United States (Ariva U.S.). Ariva U.S. has approximately 400 employees in the United States. As a result of this agreement, during the second quarter of 2013, the Company recorded a \$5 million impairment of property, plant and equipment at its Ariva U.S. location, in Impairment and write-down of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive Income. (see Note 19 Sale of Ariva U.S. for further information).

*Kamloops, British Columbia pulp facility*

On December 13, 2012, the Company announced the permanent shut down of one pulp machine at its Kamloops, British Columbia mill. This decision resulted in a permanent curtailment of Domtar's annual pulp production by approximately 120,000 air dried metric tons of sawdust softwood pulp and affected approximately 125 employees.

As a result, the Company recognized, under Impairment and write-down of property, plant and equipment, \$10 million of accelerated depreciation in the first quarter of 2013. The pulp machine has ceased production in March 2013. Furthermore, during the first quarter of 2013 the Company reversed \$1 million of severance and termination costs. During the second quarter of 2013, the Company reversed an additional \$1 million of severance and termination costs, reversed \$1 million of inventory obsolescence, and incurred \$2 million of other costs.

*Mira Loma, California converting plant*

During the first quarter of 2012, the Company recorded a \$2 million write-down of property, plant and equipment at its Mira Loma location in California, in Impairment and write-down of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive Income.

**Other Costs**

## Edgar Filing: Domtar CORP - Form 10-Q

For the three and nine months ended September 30, 2013, the Company also incurred other costs related to previous and ongoing closures which include nil and \$2 million, respectively, of severance and termination costs (2012 nil and \$1 million, respectively) and nil and nil, respectively, of other costs (2012 \$2 million and \$2 million, respectively).

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 12. CLOSURE AND RESTRUCTURING COSTS AND LIABILITY AND IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

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

	Three months ended September 30, 2013			
	Pulp and Paper	Personal Care	Corporate	Total
	\$	\$	\$	\$
Severance and termination costs				
Inventory obsolescence				
Pension settlement and withdrawal liability				
Other				

**Closure and restructuring costs**

	Nine months ended September 30, 2013			
	Pulp and Paper	Personal Care	Corporate	Total
	\$	\$	\$	\$
Severance and termination costs	(2)	2		
Inventory obsolescence	(1)			(1)
Pension settlement and withdrawal liability	11		6	17
Other	2			2
<b>Closure and restructuring costs</b>	<b>10</b>	<b>2</b>	<b>6</b>	<b>18</b>

Table of Contents

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 12. CLOSURE AND RESTRUCTURING COSTS AND LIABILITY AND IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT (CONTINUED)**

	<b>Pulp and Paper</b>	<b>Three months ended September 30, 2012 Personal Care</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Severance and termination costs			
Inventory obsolescence			
Pension settlement and withdrawal liability			
Other	1	1	2
<b>Closure and restructuring costs</b>	<b>1</b>	<b>1</b>	<b>2</b>

	<b>Pulp and Paper</b>	<b>Nine months ended September 30, 2012 Personal Care</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Severance and termination costs	1		1
Inventory obsolescence			
Pension settlement and withdrawal liability			
Other	1	1	2
<b>Closure and restructuring costs</b>	<b>2</b>	<b>1</b>	<b>3</b>

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

	<b>September 30, 2013 \$</b>
Balance at December 31, 2012	<b>10</b>
Payments	<b>(3)</b>
Pension provision (reflected in Accrued benefit obligation)	<b>(3)</b>
<b>Balance at end of period</b>	<b>4</b>

## Edgar Filing: Domtar CORP - Form 10-Q

The above provision is comprised of severance and termination costs of \$3 million in the Pulp and Paper segment and \$1 million in the Personal Care segment.



**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 13. LONG-TERM DEBT**

During the first quarter of 2013, the Company redeemed its outstanding 5.375% Notes due 2013, for par value of \$71 million. The Company incurred \$2 million of premiums paid and additional charges of \$1 million, included in Interest expense, net on the Consolidated Statement of Earnings and Comprehensive Income. The Company also repaid \$23 million of capital lease obligations to purchase the land and buildings, related to the Greenville, North Carolina site, in the Personal Care segment.

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 14. CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT**

The following table presents the changes in Accumulated other comprehensive loss by component<sup>(1)</sup>:

	Net derivative gains (losses) on cash flow hedges	Pension items	Post-retirement benefit items	Foreign currency items	Total
Balance at December 31, 2012	5	(326)	(15)	208	(128)
Natural gas swap contracts	(2)	N/A	N/A	N/A	(2)
Currency options	(3)	N/A	N/A	N/A	(3)
Net investment hedge	(1)	N/A	N/A	N/A	(1)
Foreign currency items	N/A	N/A	N/A	(27)	(27)
Remeasurement of pension plan obligation <sup>(2)</sup>	N/A	19		N/A	19
Total Other comprehensive (loss) income before reclassifications	(6)	19		(27)	(14)
Amounts reclassified from Accumulated other comprehensive loss	3	18	2		23
Net current period other comprehensive (loss) income	(3)	37	2	(27)	9
<b>Balance at September 30, 2013</b>	<b>2</b>	<b>(289)</b>	<b>(13)</b>	<b>181</b>	<b>(119)</b>

<sup>(1)</sup> All amounts are after tax.

<sup>(2)</sup> Remeasurement gains of \$19 million recorded in Accumulated other comprehensive loss related to pension. The following tables present reclassifications out of Accumulated other comprehensive loss:

Details of Accumulated other comprehensive loss components	Amount reclassified from Accumulated other comprehensive loss	Affected line item in the Consolidated Statements of
---	---	---

	For the three months ended		Earnings and Comprehensive Income
	September 30, 2013	September 30, 2012	
Net derivative losses on cash flow hedges			
Natural gas swap contracts	1	3	Cost of Sales
Currency options	2		Cost of Sales
Total before tax	3	3	
Tax benefit	(1)	(1)	Income tax benefit
Net of tax	2	2	
Amortization of defined benefit pension plans			
Net actuarial loss (gain)	7	(8)(a)	
Prior service cost	1	1 (a)	
Total before tax	8	(7)	
Tax benefit	(9)	(3)	Income tax benefit
Net of tax	(1)	(10)	

Table of Contents

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 14. CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS BY COMPONENT (CONTINUED)**

Details of Accumulated other comprehensive loss components	Amount reclassified from Accumulated other comprehensive loss For the nine months ended		Affected line item in the Consolidated Statements of Earnings and Comprehensive Income
	September 30, 2013	September 30, 2012	
Net derivative losses on cash flow hedges			
Natural gas swap contracts	3	9	Cost of Sales
Currency options	2	2	Cost of Sales
Total before tax	5	11	
Tax benefit	(2)	(4)	Income tax benefit
Net of tax	3	7	
Amortization of defined benefit pension plans			
Net actuarial loss	35	1 (a)	
Prior service cost	2	2 (a)	
Total before tax	37	3	
Tax benefit	(17)	(3)	Income tax benefit
Net of tax	20		

- (a) These Accumulated other comprehensive loss components are included in the computation of net periodic benefit cost for pension and other post-retirement benefit plans as amortization of net actuarial loss, curtailment loss and settlement loss. Refer to Note 6 for additional details.

---

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 15. SHAREHOLDERS' EQUITY**

On February 20, 2013, the Company's Board of Directors approved a quarterly dividend of \$0.45 per share to be paid to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc. Total dividends of approximately \$15 million were paid on April 15, 2013 to shareholders of record on March 15, 2013.

On April 30, 2013 and July 30, 2013, the Company's Board of Directors approved a quarterly dividend of \$0.55 per share to be paid to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc. Total dividends of approximately \$19 million and \$18 million, respectively, were paid on July 15, 2013 and October 15, 2013, respectively, to shareholders of record on June 14, 2013 and September 13, 2013, respectively.

On October 30, 2013, the Company's Board of Directors approved a quarterly dividend of \$0.55 per share to be paid to holders of the Company's common stock, as well as holders of exchangeable shares of Domtar (Canada) Paper Inc. This dividend is to be paid on January 15, 2014, to shareholders of record on December 13, 2013.

**STOCK REPURCHASE PROGRAM**

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

From 2010 through the first three quarters of 2013, the Company made open market purchases of its common stock using general corporate funds. Additionally, the Company entered 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 required the Company to make up-front payments to the counterparty financial institutions which resulted 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 three quarters of 2013, the Company repurchased 2,509,803 shares (2012 1,521,667 shares) at an average price of \$73.10 (2012 \$78.77) for a total cost of \$183 million (2012 \$120 million). Of the \$183 million shares repurchased, nil was payable at September 30, 2013 (2012 \$4 million).

Since the inception of the Program, the Company has repurchased 11,170,506 shares at an average price of \$78.48 for a total cost of \$877 million. All shares repurchased are recorded as Treasury stock on the Consolidated Balance Sheets under the par value method at \$0.01 per share.

**Table of Contents****DOMTAR CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2013****(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)****(UNAUDITED)****NOTE 16. COMMITMENTS AND CONTINGENCIES****ENVIRONMENT**

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

An action was commenced by Seaspan International Ltd. ( "Seaspan" ) in the Supreme Court of British Columbia, on March 31, 1999 against Domtar Inc. and others with respect to alleged contamination of Seaspan's site bordering Burrard Inlet in North Vancouver, British Columbia, including contamination of sediments in Burrard Inlet, due to the presence of creosote and heavy metals. Beyond the filing of preliminary pleadings, no steps have been taken by the parties in this action. On February 16, 2010, the government of British Columbia issued a Remediation Order to Seaspan and Domtar Inc. ( "responsible persons" ) in order to define and implement an action plan to address soil, sediment and groundwater issues. This Order was appealed to the Environmental Appeal Board ( "Board" ) on March 17, 2010 but there is no suspension in the execution of this Order unless the Board orders otherwise. The relevant government authorities selected a remediation approach on July 15, 2011, and on January 8, 2013, the same authorities decided that each responsible persons' implementation plan is satisfactory and that the responsible persons decide which plan is to be used. On February 6, 2013, the responsible persons appealed the January 8, 2013 decision and Seaspan applied for a stay of execution. On February 18, 2013, the Board granted an interim stay of the January 8, 2013 decision. The Board agreed to sever the Seaspan appeal and to hear it on an expedited basis. In a decision issued on May 9, 2013, the Board dismissed Seaspan's severed appeal relating to the January 8, 2013 decision and the temporary stay was lifted. Most of the remaining appeals that were to be heard before the Board have been abandoned by the parties. Seaspan and Domtar have selected a remedial plan and are in the process of applying to the Vancouver Fraser Port Authority for permitting approval. The Company has recorded an environmental reserve to address its estimated exposure and the reasonably possible loss in excess of the reserve is not considered to be material for this matter.

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

	<b>September 30, 2013 \$</b>
Balance at beginning of period	83
Additions	1
Sale of closed facility	(3)
Environmental spending	(4)
Effect of foreign currency exchange rate change	(2)
Balance at end of period	75

---

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 16. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

The Company is also a party to various proceedings relating to the cleanup of hazardous waste sites under the Comprehensive Environmental Response Compensation and Liability Act, commonly known as Superfund, and similar state laws. The EPA and/or various state agencies have notified the Company that it may be a potentially responsible party with respect to other hazardous waste sites as to which no proceedings have been instituted against the Company. The Company continues to take remedial action under its Care and Control Program at its former wood preserving sites, and at a number of operating sites due to possible soil, sediment or groundwater contamination. The investigation and remediation process is lengthy and subject to the uncertainties of changes in legal requirements, technological developments and, if and when applicable, the allocation of liability among potentially responsible parties.

*Climate change regulation*

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

In the United States, Congress has considered legislation to reduce emissions of GHGs. Although the legislation has not passed, it appears that the federal government will continue to consider methods to reduce GHG emissions from public utilities and certain other emitters. The U.S. Environmental Protection Agency ( EPA ) has adopted and implemented GHG permitting requirements for certain new sources and modifications of existing industrial facilities and has recently proposed GHG performance standards for newly constructed electric utilities under the agency's existing Clean Air Act authority. Furthermore, several states are regulating GHG emissions from public utilities and certain other significant emitters, primarily through regional GHG cap-and-trade programs. President Obama has directed the EPA to propose emission guidelines for existing electric utilities by June 1, 2014, and to finalize the regulations for both new and existing units by June 1, 2015. The U.S. Supreme Court agreed, on October 15, 2013, to review whether or not the EPA permissibly determined that its regulation under the Clean Air Act of greenhouse gas emissions from mobile sources also allows the agency to establish permitting requirements for stationary sources that emit greenhouse gases. Passage of GHG legislation by Congress or individual states, or the adoption of regulations by the EPA or analogous state agencies, that restrict emissions of GHGs in areas in which the Company conducts business could have a variety of impacts upon the Company, including requiring it to implement GHG reduction programs or to pay taxes or other fees with respect to its GHG emissions. This, in turn, will increase the Company's operating costs and capital spending. The Company does not expect to be disproportionately affected by these measures compared with other pulp and paper producers in the United States.

The Government of Canada has committed to reducing greenhouse gases by 17 percent from 2005 levels by 2020. A sector by sector approach is being used to set performance standards to reduce greenhouse gases. On September 5, 2012 final regulations were published for the coal-fired electrical generators which are scheduled to become effective July 1, 2015. The industry sector, which includes pulp and paper, is the next sector to undergo this review. The Company does not expect the performance standards to be disproportionately affected by these future measures compared with other pulp and paper producers in Canada.

The province of Quebec initiated a GHG cap-and-trade system on January 1, 2012. Reduction targets for Quebec have been promulgated and are effective January 1, 2013. The Company does not expect the cost of compliance will have a material impact on the Company's financial position, results of operations or cash flows. British Columbia imposed a carbon tax in 2008, which applies to the purchase of fossil fuels within the province. There are currently no other federal or provincial statutory or regulatory obligations that affect the emission of GHGs for the

## Edgar Filing: Domtar CORP - Form 10-Q

Company's pulp and paper operations elsewhere in Canada. The Province of Ontario is reviewing a potential regulatory program for GHG emission reductions that may include a cap-and-trade component.

While it is likely that there will be increased regulation relating to GHG emissions in the future, at this time it is not possible to estimate either a timetable for the promulgation or implementation of any new regulations or the Company's cost of compliance to said regulations. The impact could, however, be material.



---

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 16. COMMITMENTS AND CONTINGENCIES (CONTINUED)**

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

On December 2, 2011, the EPA proposed a new set of standards related to emissions from boilers and process heaters included in some of the Company's manufacturing processes. These standards are generally referred to as Boiler MACT and seek to require reductions in the emission of certain hazardous air pollutants or surrogates of hazardous air pollutants. The EPA announced the final rule on December 20, 2012 and it was subsequently published in the Federal Register on January 31, 2013 for major sources. The Company is developing plans to bring facilities affected by the Boiler MACT rule into compliance by the January 2016 regulatory deadline for major sources. The Company expects that the capital cost required to comply with the Boiler MACT rules is between \$20 million and \$30 million. The Company is currently assessing the associated increase in operating costs as well as alternate compliance strategies.

The EPA has agreed to reconsider a limited number of issues in the most recent Boiler MACT rule, and elements of EPA's rule are expected to be legally challenged. At this point, these activities do not affect the Company's compliance plans.

**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 September 30, 2013 cannot be predicted with certainty, it is management's opinion that, except as noted below, their resolution will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

On July 31, 1998, Domtar Inc. (now a 100% owned subsidiary of Domtar Corporation) acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement included a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of Domtar Inc. in specified circumstances, Domtar Inc. may be required to pay an increase in consideration of up to a maximum of \$114 million (CDN \$120 million), an amount gradually declining over a 25-year period. At March 7, 2007, the maximum amount of the purchase price adjustment was approximately \$104 million (CDN \$110 million).

On March 14, 2007, the Company received a letter from George Weston Limited (the previous owner of E.B. Eddy and a party to the purchase agreement) demanding payment of \$104 million (CDN \$110 million) as a result of the consummation of the series of transactions whereby the Fine Paper Business of Weyerhaeuser Company was transferred to the Company and the Company acquired Domtar Inc. (the Transaction). On June 12, 2007, an action was commenced by George Weston Limited against Domtar Inc. in the Superior Court of Justice of the Province of Ontario, Canada, claiming that the consummation of the Transaction triggered the purchase price adjustment and sought a purchase price adjustment of \$104 million (CDN \$110 million) as well as additional compensatory damages. On June 24, 2013, the parties agreed to settle this litigation with a payment by the Company to George Weston Limited of \$49 million (CDN \$50 million). The settlement is reflected in Other operating loss, net on the Consolidated Statements of Earnings and Comprehensive Income.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 16. 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 September 30, 2013, 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 September 30, 2013, the Company has not recorded a liability associated with these indemnifications, as it does not expect to make any payments pertaining to these indemnifications.

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 17. SEGMENT DISCLOSURES**

Following the sale of Ariva U.S. on July 31, 2013, the Company decided to merge its Distribution segment with the Pulp and Paper segment. The Company operates in the two reportable segments described below. Each reportable segment offers different products and services and requires different manufacturing processes, technology and/or marketing strategies. The following summary briefly describes the operations included in each of the Company's reportable segments:

**Pulp and Paper Segment** comprises the design, manufacturing, marketing and distribution of communication, specialty and packaging papers, as well as softwood, fluff and hardwood market pulp. The Company owns and operates Ariva®, a network of strategically located paper and printing and packaging supplies distribution facilities in Canada, involved in the purchasing, warehousing, sale and distribution of the Company's paper products and those of other manufacturers.

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

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 17. SEGMENT DISCLOSURES (CONTINUED)**

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

SEGMENT DATA	For the three months ended September 30, 2013 \$	September 30, 2012 \$	For the nine months ended September 30, 2013 \$	September 30, 2012 \$
<b>Sales</b>				
Pulp and Paper	1,204	1,280	3,650	3,870
Personal Care	175	111	394	288
Total for reportable segments	1,379	1,391	4,044	4,158
Intersegment sales Pulp and Paper	(4)	(2)	(12)	(3)
<b>Consolidated sales</b>	1,375	1,389	4,032	4,155
<b>Depreciation and amortization and impairment and write-down of property, plant and equipment</b>				
Pulp and Paper	84	90	260	274
Personal Care	9	6	21	15
Total for reportable segments	93	96	281	289
Impairment and write-down of property, plant and equipment Pulp and Paper			15	2
<b>Consolidated depreciation and amortization and impairment and write-down of property, plant and equipment</b>	93	96	296	291
<b>Operating income (loss)</b>				
Pulp and Paper	42	98	96	298
Personal Care	11	12	34	32
Corporate	(4)	(1)	(62)	(6)
<b>Consolidated operating income</b>	49	109	68	324
Interest expense, net	21	20	67	109
<b>Earnings before income taxes and equity loss</b>	28	89	1	215

# Edgar Filing: Domtar CORP - Form 10-Q

Income tax expense (benefit)	1	22	(26)	57
Equity loss, net of taxes		1	1	5
<b>Net earnings</b>	<b>27</b>	<b>66</b>	<b>26</b>	<b>153</b>

38

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 18. 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 and the successor to the Weyerhaeuser Fine Paper Business U.S. Operations, Domtar Industries LLC (and subsidiaries, excluding Domtar Funding LLC), Ariva Distribution Inc., Domtar Delaware Investments Inc., Domtar Delaware Holdings, LLC, Domtar A.W. LLC (and subsidiary), Domtar AI Inc., Attends Healthcare Inc., EAM Corporation, Associated Hygiene Products LLC and Domtar Personal Care Absorbent Hygiene Inc., all 100% owned subsidiaries of the Company ( "Guarantor Subsidiaries" ), on a joint and several basis. The Guaranteed Debt will not be guaranteed by certain of Domtar Paper Company, LLC's own 100% owned subsidiaries; including Domtar Delaware Holdings Inc., Attends Healthcare Limited and Domtar Inc., (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 September 30, 2013 and December 31, 2012 and the Statements of Earnings and Comprehensive Income for the three and nine months ended September 30, 2013 and September 30, 2012, and the Statements of Cash Flows for the nine months ended September 30, 2013 and September 30, 2012 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.

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME	For the three months ended September 30, 2013				
	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Sales</b>		1,148	494	(267)	<b>1,375</b>
<b>Operating expenses</b>					
Cost of sales, excluding depreciation and amortization		968	415	(267)	<b>1,116</b>
Depreciation and amortization		69	24		<b>93</b>
Selling, general and administrative	8	60	27		<b>95</b>
Impairment and write-down of property, plant and equipment					
Closure and restructuring costs					
Other operating loss, net	1	19	2		<b>22</b>
	9	1,116	468	(267)	<b>1,326</b>
<b>Operating (loss) income</b>	(9)	32	26		<b>49</b>
Interest expense (income), net	23	5	(7)		<b>21</b>
<b>(Loss) earnings before income taxes and equity loss</b>	(32)	27	33		<b>28</b>
Income tax (benefit) expense	(9)	4	6		<b>1</b>
Equity loss, net of taxes					
Share in earnings of equity accounted investees	50	27		(77)	
<b>Net income</b>	27	50	27	(77)	<b>27</b>
<b>Other comprehensive income</b>	2	11	42		<b>55</b>
<b>Comprehensive income</b>	29	61	69	(77)	<b>82</b>

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME	For the nine months ended September 30, 2013				
	Parent	Guarantor	Non- Guarantor	Consolidating	Consolidated
	\$	\$	\$	\$	\$
<b>Sales</b>		3,336	1,478	(782)	<b>4,032</b>
<b>Operating expenses</b>					
Cost of sales, excluding depreciation and amortization		2,819	1,243	(782)	<b>3,280</b>
Depreciation and amortization		204	77		<b>281</b>
Selling, general and administrative	21	195	65		<b>281</b>
Impairment and write-down of property, plant and equipment		5	10		<b>15</b>
Closure and restructuring costs		6	12		<b>18</b>
Other operating loss, net	1	39	49		<b>89</b>
	22	3,268	1,456	(782)	<b>3,964</b>
<b>Operating (loss) income</b>	(22)	68	22		<b>68</b>
Interest expense (income), net	72	14	(19)		<b>67</b>
<b>(Loss) earnings before income taxes and equity loss</b>	(94)	54	41		<b>1</b>
Income tax (benefit) expense	(25)	(21)	20		<b>(26)</b>
Equity loss, net of taxes			1		<b>1</b>
Share in earnings of equity accounted investees	95	20		(115)	
<b>Net earnings</b>	26	95	20	(115)	<b>26</b>
<b>Other comprehensive income (loss)</b>	3	7	(1)		<b>9</b>
<b>Comprehensive income</b>	29	102	19	(115)	<b>35</b>



**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME	For the three months ended September 30, 2012				
	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Sales</b>		1,150	492	(253)	<b>1,389</b>
<b>Operating expenses</b>					
Cost of sales, excluding depreciation and amortization		937	416	(253)	<b>1,100</b>
Depreciation and amortization		69	27		<b>96</b>
Selling, general and administrative	6	58	16		<b>80</b>
Impairment and write-down of property, plant and equipment					
Closure and restructuring costs		2			<b>2</b>
Other operating (loss) income, net		(2)	4		<b>2</b>
	6	1,064	463	(253)	<b>1,280</b>
<b>Operating (loss) income</b>	(6)	86	29		<b>109</b>
Interest expense (income), net	22	5	(7)		<b>20</b>
<b>(Loss) earnings before income taxes and equity loss</b>	(28)	81	36		<b>89</b>
Income tax (benefit) expense	(9)	22	9		<b>22</b>
Equity loss, net of taxes			1		<b>1</b>
Share in earnings of equity accounted investees	85	26		(111)	
<b>Net earnings</b>	66	85	26	(111)	<b>66</b>
<b>Other comprehensive income (loss)</b>	3	(5)	52		<b>50</b>
<b>Comprehensive income</b>	69	80	78	(111)	<b>116</b>

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING STATEMENT OF EARNINGS AND COMPREHENSIVE INCOME	For the nine months ended September 30, 2012				
	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
	\$	\$	\$	\$	\$
<b>Sales</b>		3,456	1,448	(749)	<b>4,155</b>
<b>Operating expenses</b>					
Cost of sales, excluding depreciation and amortization		2,797	1,215	(749)	<b>3,263</b>
Depreciation and amortization		222	67		<b>289</b>
Selling, general and administrative	24	210	34		<b>268</b>
Impairment and write-down of property, plant and equipment		2			<b>2</b>
Closure and restructuring costs		2	1		<b>3</b>
Other operating loss, net			6		<b>6</b>
	24	3,233	1,323	(749)	<b>3,831</b>
<b>Operating (loss) income</b>	(24)	223	125		<b>324</b>
Interest expense (income), net	114	14	(19)		<b>109</b>
<b>(Loss) earnings before income taxes and equity loss</b>	(138)	209	144		<b>215</b>
Income tax (benefit) expense	(46)	61	42		<b>57</b>
Equity loss, net of taxes			5		<b>5</b>
Share in earnings of equity accounted investees	245	97		(342)	
<b>Net earnings</b>	153	245	97	(342)	<b>153</b>
<b>Other comprehensive income (loss)</b>	5	(5)	40		<b>40</b>
<b>Comprehensive income</b>	158	240	137	(342)	<b>193</b>

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING BALANCE SHEET	September 30, 2013				Consolidated \$
	Parent \$	Guarantor Subsidiaries \$	Guarantor Subsidiaries \$	Consolidating Adjustments \$	
<b>Assets</b>					
<b>Current assets</b>					
Cash and cash equivalents	32	5	154		<b>191</b>
Receivables		396	187		<b>583</b>
Inventories		487	216		<b>703</b>
Prepaid expenses	8	11	12		<b>31</b>
Income and other taxes receivable	53		7	(12)	<b>48</b>
Intercompany accounts	454	3,784	37	(4,275)	
Deferred income taxes		43	15		<b>58</b>
<b>Total current assets</b>	<b>547</b>	<b>4,726</b>	<b>628</b>	<b>(4,287)</b>	<b>1,614</b>
<b>Property, plant and equipment, at cost</b>		<b>5,927</b>	<b>3,001</b>		<b>8,928</b>
<b>Accumulated depreciation</b>		<b>(3,670)</b>	<b>(1,906)</b>		<b>(5,576)</b>
<b>Net property, plant and equipment</b>		<b>2,257</b>	<b>1,095</b>		<b>3,352</b>
<b>Goodwill</b>		<b>296</b>	<b>71</b>		<b>367</b>
<b>Intangible assets, net of amortization</b>		<b>275</b>	<b>134</b>		<b>409</b>
<b>Investments in affiliates</b>	<b>7,538</b>	<b>2,039</b>		<b>(9,577)</b>	
<b>Intercompany long-term advances</b>	<b>6</b>	<b>79</b>	<b>652</b>	<b>(737)</b>	
<b>Other assets</b>	<b>33</b>		<b>127</b>	<b>(17)</b>	<b>143</b>
<b>Total assets</b>	<b>8,124</b>	<b>9,672</b>	<b>2,707</b>	<b>(14,618)</b>	<b>5,885</b>
<b>Liabilities and shareholders' equity</b>					
<b>Current liabilities</b>					
Bank indebtedness		6			<b>6</b>
Trade and other payables	50	435	208		<b>693</b>
Intercompany accounts	3,795	413	67	(4,275)	
Income and other taxes payable	16	7	5	(12)	<b>16</b>
Long-term debt due within one year		3	3		<b>6</b>
<b>Total current liabilities</b>	<b>3,861</b>	<b>864</b>	<b>283</b>	<b>(4,287)</b>	<b>721</b>
<b>Long-term debt</b>	<b>1,084</b>	<b>5</b>	<b>13</b>		<b>1,102</b>
<b>Intercompany long-term loans</b>	<b>530</b>	<b>207</b>		<b>(737)</b>	
<b>Deferred income taxes and other</b>		<b>877</b>	<b>69</b>		<b>946</b>

Edgar Filing: Domtar CORP - Form 10-Q

<b>Other liabilities and deferred credits</b>	14	181	257	(17)	<b>435</b>
<b>Shareholders' equity</b>	2,635	7,538	2,085	(9,577)	<b>2,681</b>
<b>Total liabilities and shareholders' equity</b>	8,124	9,672	2,707	(14,618)	<b>5,885</b>

**Table of Contents**

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING BALANCE SHEET	December 31, 2012				
	Parent	Guarantor	Non-Guarantor	Consolidating	Consolidated
	\$	Subsidiaries	Subsidiaries	Adjustments	\$
		\$	\$	\$	\$
<b>Assets</b>					
<b>Current assets</b>					
Cash and cash equivalents	275	72	314		661
Receivables		393	169		562
Inventories		472	203		675
Prepaid expenses	7	7	10		24
Income and other taxes receivable	34		14		48
Intercompany accounts	433	3,501	12	(3,946)	
Deferred income taxes		30	17	(2)	45
<b>Total current assets</b>	749	4,475	739	(3,948)	2,015
<b>Property, plant and equipment, at cost</b>		5,755	3,038		8,793
<b>Accumulated depreciation</b>		(3,500)	(1,892)		(5,392)
<b>Net property, plant and equipment</b>		2,255	1,146		3,401
<b>Goodwill</b>		194	69		263
<b>Intangible assets, net of amortization</b>		180	129		309
<b>Investments in affiliates</b>	7,208	2,018		(9,226)	
<b>Intercompany long-term advances</b>	6	85	489	(580)	
<b>Other assets</b>	30		119	(14)	135
<b>Total assets</b>	7,993	9,207	2,691	(13,768)	6,123
<b>Liabilities and shareholders' equity</b>					
<b>Current liabilities</b>					
Bank indebtedness		18			18
Trade and other payables	43	380	223		646
Intercompany accounts	3,492	398	56	(3,946)	
Income and other taxes payable	4	9	4	(2)	15
Long-term debt due within one year	47	27	5		79
<b>Total current liabilities</b>	3,586	832	288	(3,948)	758
<b>Long-term debt</b>	1,107	8	13		1,128
<b>Intercompany long-term loans</b>	444	130	6	(580)	
<b>Deferred income taxes and other</b>		873	44	(14)	903

Edgar Filing: Domtar CORP - Form 10-Q

<b>Other liabilities and deferred credits</b>	27	156	274		<b>457</b>
<b>Shareholders' equity</b>	2,829	7,208	2,066	(9,226)	<b>2,877</b>
<b>Total liabilities and shareholders' equity</b>	7,993	9,207	2,691	(13,768)	<b>6,123</b>

Table of Contents

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS	For the nine months ended September 30, 2013				
	Parent	Guarantor	Non-Guarantor	Consolidating	Consolidated
	\$	\$	\$	\$	\$
<b>Operating activities</b>					
Net earnings	26	95	20	(115)	<b>26</b>
Changes in operating and intercompany assets and liabilities and non-cash items, included in net earnings	189	(44)	1	115	<b>261</b>
Cash flows provided from operating activities	215	51	21		<b>287</b>
<b>Investing activities</b>					
Additions to property, plant and equipment		(116)	(64)		<b>(180)</b>
Proceeds from disposals of property, plant and equipment and sale of business		55			<b>55</b>
Acquisitions of businesses, net of cash acquired		(283)	(4)		<b>(287)</b>
Investment in joint venture			(1)		<b>(1)</b>
Cash flows used for investing activities		(344)	(69)		<b>(413)</b>
<b>Financing activities</b>					
Dividend payments	(50)				<b>(50)</b>
Net change in bank indebtedness		(13)			<b>(13)</b>
Repayment of long-term debt	(71)	(25)	(3)		<b>(99)</b>
Stock repurchase	(183)				<b>(183)</b>
Increase in long-term advances to related parties	(156)		(108)	264	
Decrease in long-term advances to related parties		264		(264)	
Other	2				<b>2</b>
Cash flows (used for) provided from financing activities	(458)	226	(111)		<b>(343)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(243)</b>	<b>(67)</b>	<b>(159)</b>		<b>(469)</b>
Translation adjustments related to cash and cash equivalents			(1)		<b>(1)</b>
Cash and cash equivalents at beginning of period	275	72	314		<b>661</b>
<b>Cash and cash equivalents at end of period</b>	<b>32</b>	<b>5</b>	<b>154</b>		<b>191</b>





Table of Contents

**DOMTAR CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2013**  
**(IN MILLIONS OF DOLLARS, UNLESS OTHERWISE NOTED)**  
**(UNAUDITED)**

**NOTE 18. SUPPLEMENTAL GUARANTOR FINANCIAL INFORMATION (CONTINUED)**

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS	For the nine months ended September 30, 2012				
	Parent	Guarantor	Non-Guarantor	Consolidating	Consolidated
	\$	Subsidiaries	Subsidiaries	Adjustments	\$
		\$	\$	\$	
<b>Operating activities</b>					
Net earnings	153	245	97	(342)	<b>153</b>
Changes in operating and intercompany assets and liabilities and non-cash items, included in net earnings	(105)	(64)	85	342	<b>258</b>
Cash flows provided from operating activities	48	181	182		<b>411</b>
<b>Investing activities</b>					
Additions to property, plant and equipment		(124)	(47)		<b>(171)</b>
Acquisitions of businesses, net of cash acquired		(61)	(232)		<b>(293)</b>
Investment in joint venture			(5)		<b>(5)</b>
Cash flows used for investing activities		(185)	(284)		<b>(469)</b>
<b>Financing activities</b>					
Dividend payments	(42)				<b>(42)</b>
Net change in bank indebtedness		8			<b>8</b>
Issuance of long-term debt	548				<b>548</b>
Repayment of long-term debt	(186)	(3)	(1)		<b>(190)</b>
Stock repurchase	(116)				<b>(116)</b>
Increase in long-term advances to related parties	(42)		(20)	62	
Decrease in long-term advances to related parties		62		(62)	
Other	(1)				<b>(1)</b>
Cash flows provided from (used for) financing activities	161	67	(21)		<b>207</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>209</b>	<b>63</b>	<b>(123)</b>		<b>149</b>
Cash and cash equivalents at beginning of period	91	2	351		<b>444</b>
<b>Cash and cash equivalents at end of period</b>	<b>300</b>	<b>65</b>	<b>228</b>		<b>593</b>

**Table of Contents**

**DOMTAR CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2013**

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

**(UNAUDITED)**

**NOTE 19. SALE OF ARIVA U.S.**

*Ariva U.S.*

On July 31, 2013, the Company completed the sale of its Ariva U.S. business to Central National Gottesman Inc. for net proceeds of \$45 million. The sale resulted in a net loss on disposal of the Ariva U.S. business of \$19 million in the third quarter of 2013 and has been recorded as a component of Other operating loss on the Consolidated Statements of Earnings and Comprehensive Income. The \$19 million net loss consists of the following; \$11 million of withdrawal liabilities relating to the multi-employer pension plan, \$3 million of severance costs, \$3 million loss on sale of net assets and \$2 million relating to other provisions. The Company recorded a \$5 million impairment of property, plant and equipment in the second quarter of 2013.

## **Table of Contents**

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with Domtar Corporation's unaudited interim consolidated financial statements and notes thereto included elsewhere in the Quarterly Report. The MD&A should also be read in conjunction with the historical financial information contained in our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission ( SEC ) on February 28, 2013. Throughout this MD&A, unless otherwise specified, Domtar Corporation, the Company, Domtar, we, us and our refer to Domtar Corporation and its subsidiaries, as well as investments. Domtar Corporation's common stock is listed on the New York Stock Exchange and the Toronto Stock Exchange. Except where otherwise indicated, all financial information reflected herein is determined on the basis of accounting principles generally accepted in the United States ( GAAP ).

In accordance with industry practice, in this report, the term ton or the symbol ST refers to a short ton, an imperial unit of measurement equal to 0.9072 metric tons. The term metric ton or the symbol ADMT refers to an air dry metric ton. In this report, unless otherwise indicated, all dollar amounts are expressed in U.S. dollars, and the term dollars and the symbol \$ refer to U.S. dollars. In the following discussion, unless otherwise noted, references to increases or decreases in income and expense items, prices, contribution to net earnings (loss), and shipment volume are based on the three-month and nine-month periods ended September 30, 2013 and 2012. The three-month and nine-month periods are also referred to as the third quarter of 2013 and 2012, and the first nine months of 2013 and 2012, respectively.

### **EXECUTIVE SUMMARY**

On July 31, 2013, we sold our Ariva business in the United States ( Ariva U.S. ). The results of our former Distribution segment have been reclassified under the Pulp and Paper segment.

In the third quarter of 2013, we reported an operating income of \$49 million, an increase of \$79 million compared to an operating loss of \$30 million in the second quarter of 2013. Our results of the second quarter were impacted by the settlement of a litigation with George Weston Limited for \$49 million. In addition, our operating results improved when compared to the second quarter of 2013 mostly from an increase in operating income in our Pulp and Paper segment.

In our Pulp and Paper segment, our operating income increased by \$26 million when compared to the second quarter of 2013. This increase in operating income is mostly due to a decrease in maintenance costs (\$11 million), a decrease in restructuring charges (\$10 million), higher volume (\$9 million), lower costs of raw materials (\$5 million), higher average selling prices for pulp (\$3 million, reflecting a selling price increase of approximately 1% when compared to the second quarter of 2013), and the positive impact of a weaker Canadian dollar on our Canadian denominated expenses (\$3 million). These increases in operating income were partially offset by a loss on sale of Ariva U.S. business of \$19 million recorded in the third quarter of 2013 as well as an increase in fixed costs and other (\$5 million). For more details on this sale, refer to Item 1, Financial Statements and Supplementary Data, of this Form 10-Q, under Note 19 Sale of Ariva U.S.

In our Personal Care segment, our operating income increased by \$1 million when compared to the second quarter of 2013. This increase in operating income is mostly due to the acquisition of Associated Hygienic Products LLC ( AHP ) on July 1, 2013 as well as a decrease in restructuring charges (\$2 million). These increases were partially offset by higher selling, general and administrative expenses as well as costs of raw materials when compared to the second quarter of 2013.

### *Outlook*

Our pulp business should benefit from accelerating momentum in global demand, notably in China. The recently announced price increases for several paper grades are expected to positively impact results towards the end of the fourth quarter. We expect higher input costs due to higher usage in the winter months and we should see lower paper sales volumes in the fourth quarter due to seasonality. Looking out to 2014, we should continue to benefit from the recently announced paper price increases and our personal care business will continue to see earnings growth.

### **Closure and Restructuring Activities and Impairment and Write-down of Property, Plant and Equipment and Intangible Assets**

#### *Multiemployer Pension Plan*

In relation to the withdrawal from one of our multiemployer pension plans in 2011, we recorded an additional charge to earnings of \$1 million due to a change in the estimated withdrawal liability during the first quarter of 2013. During the second quarter of 2013, we decided to withdraw from another one of our multiemployer pension plans and recorded a withdrawal liability and a charge to earnings of \$3 million. At September 30, 2013, the total provision for the withdrawal liabilities is \$51 million. While this is our best estimate of the ultimate cost of the

## Edgar Filing: Domtar CORP - Form 10-Q

withdrawal from these plans at September 30, 2013, additional withdrawal liabilities may be incurred based on the final fund assessment expected to occur in the fourth quarter of 2013. Further, we remain liable for potential additional withdrawal liabilities to the fund in the event of a mass withdrawal, as defined by statute, occurring anytime within the next three years.

## **Table of Contents**

During the second quarter of 2013, we also incurred pension settlement losses related to the previously closed Big River sawmill and Dryden paper mill for \$6 million and \$7 million, respectively.

### *Ariva U.S.*

At the end of July 2013, we sold our Ariva U.S. business. Ariva U.S. had approximately 400 employees in the United States. During the second quarter of 2013, we recorded a \$5 million charge related to impairment of property, plant and equipment on our former Ariva U.S. assets, in Impairment and write-down of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive Income. In addition, in the third quarter of 2013, we recorded a loss on sale of \$19 million. For more details on this sale, refer to Item 1, Financial Statements and Supplementary Data, of this Form 10-Q, under Note 19 Sale of Ariva U.S.

### *Kamloops, British Columbia pulp facility 2012 and 2013*

On December 13, 2012, we announced the permanent shut down of one pulp machine at our Kamloops, British Columbia mill. This decision resulted in a permanent curtailment of our annual pulp production by approximately 120,000 air dried metric tons of sawdust softwood pulp and affected approximately 125 employees. As a result, we recorded \$10 million of accelerated depreciation, a component of Impairment and write-down of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive Income in the first quarter of 2013. The pulp machine ceased production in March 2013. Furthermore, during the first quarter of 2013, we reversed \$1 million of severance and termination costs. During the second quarter of 2013, we reversed an additional \$1 million of severance and termination costs and \$1 million of inventory obsolescence, and incurred \$2 million of other costs.

### *Mira Loma, California converting plant 2012*

During the first quarter of 2012, we recorded a \$2 million write-down of property, plant and equipment at our Mira Loma California converting plant, in Impairment and write-down of property, plant and equipment on the Consolidated Statement of Earnings and Comprehensive Income.

### *Other Costs*

For the three and nine months ended September 30, 2013, we also incurred other costs related to previous closures which include nil and \$2 million, respectively, of severance and termination costs (2012 nil and \$1 million, respectively) and nil and nil, respectively, of other costs (2012- \$2 million and \$2 million, respectively).

We continue to evaluate potential adjustments to our production capacity, which may include additional closures of machines or entire mills, and we could recognize significant cash and/or non-cash charges relating to any such closures in future periods. For information relating to all our closure and restructuring activities, refer to Item 1, Financial Statements and Supplementary Data, of this Form 10-Q, under Note 12 Closure and Restructuring Costs and Liability and Impairment of Property, Plant and Equipment.

## **OUR BUSINESS**

Information relating to our business is contained in our Annual Report on Form 10-K for the year ended December 31, 2012. There has not been any material change in our business since December 31, 2012. On July 31, 2013, we sold our Ariva U.S. business and the results of the former Distribution segment have been reclassified under the Pulp and Paper segment.

We now operate in two reportable segments as described below. Each reportable segment offers different products and services and requires different manufacturing processes, technology and/or marketing strategies.

The following summary briefly describes the operations included in each of our reportable segments:

**Pulp and Paper:** Our Pulp and Paper segment comprises the design, manufacturing, marketing and distribution of communication and specialty and packaging papers, as well as softwood, fluff and hardwood market pulp. We own and operate Ariva®, a network of strategically located paper, printing and packaging supplies distribution facilities in Canada, involved in the purchasing, warehousing, sale and distribution of our paper products and those of other manufacturers.



**Table of Contents**

**Personal Care:** Our Personal Care segment consists of the design, manufacturing, marketing and distribution of adult incontinence products, absorbent hygiene products and infant diapers.

**CONSOLIDATED RESULTS OF OPERATIONS AND SEGMENTS REVIEW**

The following table includes the consolidated financial results of Domtar Corporation for the third quarter of 2013 and 2012 and the first nine months of 2013 and 2012:

	Three months ended		Nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
<b>FINANCIAL HIGHLIGHTS</b>				
<i>(In millions of dollars, unless otherwise noted)</i>				
Sales	\$ 1,375	\$ 1,389	\$ 4,032	\$ 4,155
Operating income	49	109	68	324
Net earnings	27	66	26	153
Net earnings per common share (in dollars) <sup>1</sup> :				
Basic	0.83	1.85	0.77	4.21
Diluted	0.82	1.84	0.77	4.20
Operating income (loss) per segment:				
Pulp and Paper	\$ 42	\$ 98	\$ 96	\$ 298
Personal Care	11	12	34	32
Corporate	(4)	(1)	(62)	(6)
Total	\$ 49	\$ 109	\$ 68	\$ 324
			At September 30, 2013	At December 31, 2012
Total assets			\$ 5,885	\$ 6,123
Total long-term debt, including current portion			\$ 1,108	\$ 1,207

<sup>1</sup> Refer to Note 5 of the consolidated financial statements included in Item 1 of this Form 10-Q, for more information on the calculation of net earnings per common share.

## **Table of Contents**

### **THIRD QUARTER 2013 VERSUS**

### **THIRD QUARTER 2012**

#### **Sales**

Sales for the third quarter of 2013 amounted to \$1,375 million, a decrease of \$14 million, or 1%, from sales of \$1,389 million in the third quarter of 2012. This decrease in sales is mainly attributable to the sale of our Ariva U.S. business in the third quarter of 2013 (\$52 million), a decrease in our pulp and manufactured paper sales volume (\$36 million and \$11 million, respectively, a decrease of approximately 14% in our pulp shipments and a decrease of approximately 1% in our paper manufactured shipments) and a decrease in our net average selling price for manufactured paper (\$24 million, a decrease of approximately 3% in our net average selling price when compared to the third quarter of 2012). This decrease was partially offset by the inclusion of sales from our newly acquired business AHP since July 1, 2013 (\$64 million), an increase in our paper sales volume sourced from third parties (\$24 million) and an increase in our total average selling price for pulp (\$16 million, reflecting a selling price increase of approximately 7% when compared to the total average selling price in the third quarter of 2012).

#### **Cost of Sales, excluding Depreciation and Amortization**

Cost of sales, excluding depreciation and amortization, amounted to \$1,116 million in the third quarter of 2013, an increase of \$16 million, or 1%, compared to cost of sales, excluding depreciation and amortization, of \$1,100 million in the third quarter of 2012. In our Pulp and Paper segment, this increase is mainly attributable to the cost of sales relating to higher paper sales volume sourced from third parties (\$21 million), higher maintenance costs (\$12 million), the negative impact of lower pulp and paper production volume (\$9 million), higher costs of raw materials including energy (\$5 million), fiber (\$5 million) and chemicals (\$1 million), higher freight costs (\$7 million) and higher compensation costs (\$4 million). These increases were partially offset by the sale of our Ariva U.S. business in the third quarter of 2013 (\$50 million), a decrease in our pulp and manufactured paper shipments (\$32 million and \$10 million, respectively) as well as overall favorable exchange rates, net of our hedging program (\$10 million). In our Personal Care segment, the increase is mostly due to the inclusion of cost of sales of AHP (\$55 million).

#### **Depreciation and Amortization**

Depreciation and amortization amounted to \$93 million in the third quarter of 2013, a decrease of \$3 million, or 3%, compared to depreciation and amortization of \$96 million in the third quarter of 2012. In our Pulp and Paper segment, depreciation and amortization decreased by \$6 million, primarily due to several assets reaching the end of their useful lives and reduced assets following the permanent shut down of a pulp machine at Kamloops in the first quarter of 2013. In our Personal Care segment, depreciation and amortization expense increased by \$3 million, primarily as a result of the inclusion of AHP.

#### **Selling, General and Administrative Expenses**

SG&A expenses amounted to \$95 million in the third quarter of 2013, an increase of \$15 million, or 19%, compared to SG&A expenses of \$80 million in the third quarter of 2012. This increase in SG&A is primarily due to the curtailment gain of a post-retirement benefit plan of \$13 million in the third quarter of 2012, higher stock based compensation expense as a result of mark-to-market adjustments (\$2 million), the inclusion of SG&A expenses for AHP for a full quarter (\$5 million) and an increase in general administrative charges (\$8 million). These increases were partially offset by lower charges for our variable compensation program (\$6 million) as well as the sale of our Ariva U.S. business (\$7 million).

#### **Other Operating Loss, Net**

Other operating loss, net amounted to \$22 million in the third quarter of 2013, an increase of \$20 million compared to other operating loss, net of \$2 million in the third quarter of 2012. This increase in other operating loss, net is primarily due to the loss on sale of our Ariva U.S. business following the completion of its sale on July 31, 2013 (\$19 million).

#### **Operating Income**



## Edgar Filing: Domtar CORP - Form 10-Q

Operating income in the third quarter of 2013 amounted to \$49 million, a decrease of \$60 million compared to operating income of \$109 million in the third quarter of 2012, due mostly to the factors mentioned above. In addition, restructuring charges of \$2 million were incurred in the third quarter of 2012, compared to nil in the third quarter of 2013, as discussed above.

## **Table of Contents**

### **Interest Expense, Net**

We incurred \$21 million of net interest expense in the third quarter of 2013, an increase of \$1 million compared to net interest expense of \$20 million in the third quarter of 2012. This increase in net interest expense is primarily due to the issuance of \$250 million of 6.25% Notes due 2042, for net proceeds of \$247 million in the third quarter of 2012 (\$2 million) and is offset by a decrease in interest expense as a result of the redemption of our outstanding 5.375% Notes due 2013, for par value of \$71 million in the first quarter of 2013 (\$1 million).

### **Income Taxes**

For the third quarter of 2013, our income tax expense amounted to \$1 million, consisting of a current tax expense of \$10 million and a deferred tax benefit of \$9 million. This compares to an income tax expense of \$22 million in the third quarter of 2012, consisting of a current tax expense of \$17 million and a deferred tax expense of \$5 million. We made income tax payments, net of refunds, of \$1 million during the third quarter of 2013. Our effective tax rate for the third quarter was 4% compared to an effective tax rate of 25% in the third quarter of 2012. The effective tax rates for both the third quarter of 2013 and the third quarter of 2012 were impacted by the recognition of additional tax benefits related to the finalization of certain estimates in connection with the filing of our 2012 and 2011 tax returns, respectively. Additionally, the effective tax rate for the third quarter of 2013 was impacted by the benefit of enacted state and provincial tax law changes in North Carolina and British Columbia.

### **Equity Loss**

We incurred an equity loss of nil with regard to our joint venture Celluforce Inc. in the third quarter of 2013 (2012- \$1 million, net of taxes).

### **Net Earnings**

Net earnings amounted to \$27 million (\$0.82 per common share on a diluted basis) in the third quarter of 2013, a decrease of \$39 million compared to net earnings of \$66 million (\$1.84 per common share on a diluted basis) in the third quarter of 2012, mainly due to the factors mentioned above.

**Table of Contents****FIRST NINE MONTHS OF 2013 VERSUS****FIRST NINE MONTHS OF 2012****Sales**

Sales for the first nine months of 2013 amounted to \$4,032 million, a decrease of \$123 million, or 3%, from sales of \$4,155 million in the first nine months of 2012. In our Pulp and Paper segment, this decrease in sales is mainly attributable to the sale of our Ariva U.S. business on July 31, 2013 as well as a decrease in deliveries of our former Ariva U.S. business for the first half of 2013 when compared to the first half of 2012 (\$52 million and \$36 million, respectively), a decrease in our manufactured paper sales volume (\$77 million, a decrease of approximately 3% in manufactured paper shipments, when compared to the first nine months of 2012) and a decrease in our pulp sales volume (\$56 million, a decrease of approximately 7% in pulp shipments when compared to the first nine months of 2012). In addition, our net average selling price for manufactured paper decreased when compared to the first nine months of 2012 (\$71 million, reflecting a net average selling price decrease of approximately 3%). These decreases were partially offset by the increase in our paper sales volume sourced from third parties (\$32 million). In addition, our total average selling price for pulp increased when compared to the first nine months of 2012 (\$21 million, reflecting a total average selling price increase of approximately 3% when compared to the total average selling price in the first nine months of 2012). In our Personal Care segment, the increase in sales is primarily due to the inclusion of AHP for a full quarter (\$64 million), and a full nine months of sales from Attends Healthcare Limited ( Attends Europe ) and EAM Corporation ( EAM ) following their acquisitions in the first and second quarters of 2012, respectively.

**Cost of Sales, excluding Depreciation and Amortization**

Cost of sales, excluding depreciation and amortization, amounted to \$3,280 million in the first nine months of 2013, an increase of \$17 million, or less than 1%, compared to cost of sales, excluding depreciation and amortization, of \$3,263 million in the first nine months of 2012. In our Pulp and Paper segment, this increase is mainly attributable to higher paper sales volume sourced from third parties (\$28 million), the negative impact of lower paper and pulp production volume (\$36 million), higher maintenance costs (\$30 million), higher costs of raw materials, including fiber (\$14 million), energy (\$13 million) and chemicals (\$6 million), higher freight costs (\$12 million) and higher compensation costs (\$11 million). These increases were partially offset by the sale of our Ariva U.S. business in the third quarter of 2013 as well as lower deliveries of our former Ariva U.S. business in the first half of 2013 when compared to the first half of 2012 (\$50 million and \$31 million, respectively), lower shipments of manufactured paper and pulp (\$61 million and \$50 million, respectively), as well as favorable exchange rates, net of our hedging program (\$16 million). In our Personal Care segment, cost of sales increased primarily due to the inclusion of AHP for a full quarter (\$55 million) as well as the inclusion of a full nine months of cost of sales for Attends Europe and EAM. In addition, unfavorable exchange rates, net of our hedging program amounted to \$2 million. These increases were partially offset by lower freight costs (\$1 million).

**Depreciation and Amortization**

Depreciation and amortization amounted to \$281 million in the first nine months of 2013, a decrease of \$8 million, or 3%, compared to depreciation and amortization of \$289 million in the first nine months of 2012. In our Pulp and Paper segment, depreciation and amortization decreased by \$14 million, primarily due to several assets reaching their useful lives, reduced assets following the permanent shut down of a pulp machine at Kamloops, reduced assets following the write down of intangible assets in the fourth quarter of 2012 and the impairment of property, plant and equipment in the second quarter of 2013, both related to our former Ariva U.S. business. In our Personal Care segment, depreciation and amortization expenses increased by \$6 million, primarily due to the inclusion of AHP for a full quarter as well as the inclusion of a full nine months for Attends Europe and EAM.

**Selling, General and Administrative Expenses**

SG&A expenses amounted to \$281 million in the first nine months of 2013, an increase of \$13 million, or 5%, compared to SG&A expenses of \$268 million in the first nine months of 2012. This increase in SG&A is primarily due to the curtailment gain of a post-retirement benefit plan of \$13 million in the third quarter of 2012, higher sales and marketing expenses (\$6 million) and costs incurred for the creation of our new divisional head office in Raleigh, North Carolina for our Personal Care segment (\$5 million). In addition, SG&A expenses also increased due to the inclusion of AHP (\$5 million) for a full quarter and a full nine months of Attends Europe and EAM. These increases were partially offset by lower mark-to-market adjustments on stock-based compensation (\$10 million), lower merger and acquisition expenses (\$4 million) and lower

expense for our variable compensation program (\$2 million) in the first nine months of 2013 when compared to the first nine months of 2012.

**Table of Contents****Other Operating Loss, Net**

Other operating loss, net amounted to \$89 million in the first nine months of 2013, an increase of \$83 million compared to other operating loss, net of \$6 million in the first nine months of 2012. This increase in other operating loss, net is primarily due to the payment for the litigation settlement with George Weston Limited (\$49 million) in the second quarter of 2013, the conversion of Alternative Fuel Tax Credit ( AFTC ) to Cellulosic Biofuel Producer Credit ( CBPC ) (\$26 million) in the first quarter of 2013 and the loss on sale of Ariva U.S. business (\$19 million) in the third quarter of 2013. In addition, there was a payment for a litigation settlement at Dryden (\$1 million) in the second quarter of 2013. These increases were partially offset by the gain on sale of Port Edwards assets (\$10 million) in the first quarter of 2013, favorable foreign exchange on working capital items (\$4 million) and a gain for a litigation settlement related to Lebel-sur-Quévillon, a former mill (\$2 million) in the second quarter of 2013.

**Operating Income**

Operating income in the first nine months of 2013 amounted to \$68 million, a decrease of \$256 million compared to operating income of \$324 million in the first nine months of 2012, due mostly to the factors mentioned above. In addition, we recognized an impairment and write-down of property, plant and equipment costs as a result of an accelerated depreciation charge of \$10 million from the closure of a pulp machine at our Kamloops pulp mill in the first quarter of 2013 and impairment and write-down of property, plant and equipment charge of \$5 million related to property, plant and equipment for our former Ariva U.S. assets in the second quarter of 2013. This compares to a charge of \$2 million in the first nine months of 2012 related to our Mira Loma location. Restructuring charges of \$18 million were recorded in the first nine months of 2013 compared to \$3 million in the first nine months of 2012, as discussed above.

**Interest Expense, Net**

We incurred \$67 million of net interest expense in the first nine months of 2013, a decrease of \$42 million compared to net interest expense of \$109 million in the first nine months of 2012. This decrease in net interest expense is primarily due to the premium paid on the repurchase of our 10.75% Notes due 2017, 9.5% Notes due 2016, 7.125% Notes due 2015 and 5.375% Notes due 2013, on which we incurred \$47 million of tender premiums and \$3 million of additional charges as a result of this extinguishment in the first nine months of 2012, whereas in the first nine months of 2013, we recorded a charge of \$2 million due to premiums paid on the repayment of our 5.375% Notes due 2013 and \$1 million of additional charges. As a result of the repurchase in 2012, interest expense on those Notes decreased (\$6 million). This decrease was partially offset by the increase in interest expense as a result of the issuance of the \$300 million of 4.4% Notes due 2022 and the issuance of \$250 million of 6.25% Notes due 2042, in the first quarter and third quarter of 2012, respectively.

**Income Taxes**

For the first nine months of 2013, our income tax benefit amounted to \$26 million, consisting of a current tax benefit of \$17 million and a deferred tax benefit of \$9 million. This compares to an income tax expense of \$57 million in the first nine months of 2012, consisting of a current tax expense of \$44 million and a deferred tax expense of \$13 million. We received income tax refunds, net of payments, of \$8 million during the first nine months of 2013. Our effective tax rate for the first nine months of 2013 was negative compared to the effective tax rate of 27% for the first nine months of 2012. The tax benefit for the first nine months of 2013 was impacted by the conversion of \$26 million of AFTC from the 2009 tax year into \$55 million of CBPC (\$33 million benefit after-tax) as well as a reduction of unrecognized tax benefits of \$8 million previously associated with AFTC from 2009 that were converted into CBPC, and the enacted tax changes in North Carolina and British Columbia. These tax benefits were partially offset by the \$49 million litigation settlement payment due to \$38 million being non-deductible for income tax purposes. The effective tax rate for the first nine months of 2012 was impacted by the tax benefit on \$50 million of debt premium and repurchase costs as well as by the recognition of additional tax benefits related to the finalization of certain estimates in connection with the filing of our 2011 tax return.

The Company's gross unrecognized tax benefits were reduced in the first nine months of 2013 by the reduction of \$8 million for unrecognized tax benefits previously associated with AFTC from 2009 that were converted into CBPC in the first quarter of 2013, partially offset by \$5 million of accrued interest.

**Equity Loss**

We incurred a \$1 million equity loss, net of taxes of nil, with regard to our joint venture Celluforce Inc. in the first nine months of 2013 (2012-\$5 million).

**Net Earnings**

## Edgar Filing: Domtar CORP - Form 10-Q

Net earnings amounted to \$26 million (\$0.77 per common share on a diluted basis) in the first nine months of 2013, a decrease of \$127 million compared to net earnings of \$153 million (\$4.20 per common share on a diluted basis) in the first nine months of 2012, mainly due to the factors mentioned above.

**Table of Contents****PULP AND PAPER**

<b>SELECTED INFORMATION</b> <i>(In millions of dollars, unless otherwise noted)</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2013</b>	<b>September 30, 2012</b>	<b>September 30, 2013</b>	<b>September 30, 2012</b>
<b>Sales</b>				
Total sales	<b>\$ 1,204</b>	\$ 1,280	<b>\$ 3,650</b>	\$ 3,870
Operating income	<b>42</b>	98	<b>96</b>	298
<b>Shipments</b>				
Paper (in thousands of ST) manufactured	<b>814</b>	826	<b>2,443</b>	2,515
Pulp (in thousands of ADMT) third party	<b>352</b>	415	<b>1,068</b>	1,172
<b>Sales and Operating Income</b>				

*Sales*

Sales in our Pulp and Paper segment amounted to \$1,204 million in the third quarter of 2013, a decrease of \$76 million, or approximately 6%, compared to sales of \$1,280 million in the third quarter of 2012. This decrease in sales is mostly attributable to the sale of our Ariva U.S. business on July 31, 2013 (\$52 million), a decrease in our pulp and manufactured paper sales volume (\$36 million and \$11 million, respectively, a decrease of approximately 14% in our pulp shipments and a decrease of approximately 1% in our manufactured paper shipments) and a decrease in our net average selling price for manufactured paper (\$24 million, a decrease of approximately 3% in our average selling price when compared to the third quarter of 2012). These decreases were partially offset by an increase in our paper sales volume sourced from third parties (\$24 million) and an increase in our total average selling price for pulp (\$16 million, reflecting an average selling price increase of approximately 7%) when compared to the third quarter of 2012.

Sales in our Pulp and Paper segment amounted to \$3,650 in the first nine months of 2013, a decrease of \$220 million, or approximately 6%, compared to sales of \$3,870 million in the first nine months of 2012. The decrease in sales is mainly attributable to the sale of our Ariva U.S. business on July 31, 2013 as well as a decrease in deliveries of our former Ariva U.S. business for the first half of 2013 when compared to the first half of 2012 (\$52 million and \$36 million, respectively), a decrease in our manufactured paper sales volume (\$77 million, a decrease of approximately 3% in manufactured paper shipments, when compared to the first nine months of 2012) and a decrease in our pulp sales volume (\$56 million, a decrease of approximately 7% in pulp shipments when compared to the first nine months of 2012). In addition, our net average selling price for manufactured paper decreased when compared to the first nine months of 2012 (\$71 million, reflecting a net average selling price decrease of approximately 3% when compared to the first nine months of 2012). These decreases were partially offset by an increase in our paper sales volume from third parties (\$32 million) and an increase in our total average selling price for pulp when compared to the first nine months of 2012 (\$21 million, reflecting a total average selling price increase of approximately 3%).

*Operating Income*

Operating income in our Pulp and Paper segment amounted to \$42 million in the third quarter of 2013, a decrease of \$56 million, when compared to operating income of \$98 million in the third quarter of 2012. Overall, our operating results declined when compared to the third quarter of 2012, primarily due to lower average selling prices for manufactured paper as described above, the negative impact of lower pulp production volume (\$13 million, due primarily to the closure of a pulp machine at Kamloops as well as duration of the outages), higher maintenance costs (\$12 million), higher costs of raw materials, including energy (\$5 million, due primarily to the increase in natural gas usage following the natural gas conversion), fiber (\$5 million, as a result of an increase in higher priced softwood chips) and chemicals (\$1 million) and lower shipments of pulp (\$4 million) and manufactured paper (\$3 million). In addition, we had higher freight costs (\$7 million), higher compensation costs (\$4 million) and higher selling, general and administrative expenses (\$3 million) in the third quarter of 2013 when compared to the third quarter of 2012. These increases were partially offset by higher total average selling price for pulp (\$16 million), the sale of our Ariva U.S. business in the third quarter of 2013 (\$11 million) and the positive impact of a weaker Canadian dollar on our Canadian denominated expenses, net of our hedging program (\$10 million). In the third quarter of 2012, we had restructuring charges of \$1 million relating to severance and termination costs on previous closures, compared to nil in the third quarter of 2013.





## **Table of Contents**

For the first nine months of 2013, operating income in our Pulp and Paper segment amounted to \$96 million, a decrease of \$202 million, when compared to operating income of \$298 million in the first nine months of 2012. The decrease is mostly attributable to lower net average selling prices for manufactured paper as described above, the negative impact of lower paper and pulp production volume (\$36 million), higher maintenance costs (\$30 million), lower shipments of manufactured paper (\$17 million) and pulp (\$6 million), higher costs of raw materials, including fiber (\$14 million), energy (\$13 million) and chemicals (\$6 million), higher freight costs (\$12 million) and higher compensation costs (\$11 million). In addition, restructuring charges increased as discussed above (\$8 million) and impairment charges increased (\$13 million) primarily due to accelerated depreciation charges relating to the closure of a pulp machine at Kamloops in the first quarter of 2013. We also converted AFTC to CBPC (\$26 million) in the first quarter of 2013 and recorded a loss on sale of property, plant and equipment in relation to the sale of our Ariva U.S. business (\$19 million) in the third quarter of 2013. These decreases were partially offset by the positive impact of a weaker Canadian dollar on our Canadian denominated expenses, net of our hedging program (\$16 million) and higher total average selling prices for pulp (\$21 million). The decrease was also partially offset by the gain on sale of Port Edwards assets (\$10 million) in the first quarter of 2013.

## **Pricing Environment**

### *Paper*

Average sales prices for our manufactured paper business experienced a decrease of \$30/ton or approximately 3%, in the third quarter of 2013 compared to the third quarter of 2012.

For the first nine months of 2013, our average paper sales prices for our manufactured paper business decreased when compared to the first nine months of 2012. Our average sales prices were lower by \$29/ton, or approximately 3% in the first nine months of 2013 compared to the first nine months of 2012.

### *Pulp*

Our total average pulp sales prices experienced an increase of \$44/metric ton, or approximately 7%, in the third quarter of 2013 compared to the third quarter of 2012.

For the first nine months of 2013, our total average pulp sales prices increased when compared to the first nine months of 2012. Our average sales prices were higher by \$19/metric ton, or approximately 3%, in the first nine months of 2013 compared to the first nine months of 2012.

## **Operations**

### *Paper Shipments*

Our manufactured paper shipments decreased by 12,000 tons, or approximately 1%, in the third quarter of 2013 compared to the third quarter of 2012, primarily due to a decrease in market demand for our paper.

For the first nine months of 2013, our manufactured paper shipments decreased by 72,000 tons, or approximately 3% when compared to the first nine months of 2012. The decrease in the first nine months of 2013 when compared to the first nine months of 2012 is primarily due to lower market demand.

### *Pulp Shipments*

Our pulp trade shipments, decreased by 63,000 metric tons, or approximately 15%, in the third quarter of 2013 compared to the third quarter of 2012.

For the first nine months of 2013, our pulp trade shipments decreased by 104,000 metric tons, or approximately 9%, when compared to the first nine months of 2012, and were impacted by the factors mentioned above.

### *Labor*

In the U.S., an umbrella agreement with the United Steelworkers Union ( USW ) expiring in 2015 and affecting approximately 2,900 employees at eight U.S. mills and one converting operation was ratified effective December 1, 2011. This agreement only covers certain economic

## Edgar Filing: Domtar CORP - Form 10-Q

elements, and all other issues are negotiated at each operating location, as the related collective bargaining agreements ( CBAs ) become subject to renewal. The parties have agreed not to strike or lock-out during the terms of the respective local agreements. Should the parties fail to reach an agreement during the local negotiations, the related collective bargaining agreements are automatically renewed for another four years. In 2013, local agreements have been ratified at Rothschild, Johnsonburg, Owensboro Converting and Nekoosa. Renewal agreements occurred at Plymouth and Port Huron.

## **Table of Contents**

In Canada, all agreements are ratified. Ariva Canada will begin bargaining in the last quarter of 2013 at Lachine and Quebec City locations. The Ottawa warehouse agreement expires December 2013 but will be delayed and conducted with the Mississauga Warehouse union in first quarter 2014. All union locals in Canada that were formerly known as the Communications, Energy and Paperworker Union of Canada ( CEP ) will now be referred to as Unifor due to CEP's merger with Canadian Auto Workers ( CAW ) to create Unifor.

Canadian collective agreements are unrelated to the umbrella agreement with the USW covering our U.S. locations.

### *Alternative Fuel Tax Credit and Cellulosic Biofuel Producer Credit*

The U.S. Internal Revenue Code of 1986, as amended (the Code ) permitted a refundable excise tax credit, until the end of 2009, for the production and use of alternative biofuel mixtures derived from biomass. We submitted an application with the Internal Revenue Service ( IRS ) to be registered as an alternative fuel mixer and received notification that our registration had been accepted in late March 2009. We began producing and consuming alternative fuel mixtures in February 2009 at our eligible mills. The amounts for the refundable credits are based on the volume of alternative biofuel mixtures produced and burned during that period. We received \$508 million in refunds, net of federal income tax offsets.

In July 2010, the U.S. IRS Office of Chief Counsel released an Advice Memorandum concluding that qualifying cellulosic biofuel sold or used before January 1, 2010, is eligible for the CBPC and would not be required to be registered by the Environmental Protection Agency. Each gallon of qualifying cellulose biofuel produced by any taxpayer operating a pulp and paper mill and used as a fuel in the taxpayer's trade or business during calendar year 2009 would qualify for the \$1.01 non-refundable CBPC. A taxpayer could be able to claim the credit on its federal income tax return for the 2009 tax year upon the receipt of a letter of registration from the IRS and any unused CBPC could be carried forward until 2016 to offset a portion of federal taxes otherwise payable.

We had approximately 207 million gallons of cellulose biofuel that qualified for this CBPC for which we had not previously claimed under the AFTC that represented \$209 million of CBPC or \$127 million of after tax benefit to us. In July 2010, we submitted an application with the IRS to be registered for the CBPC and on September 28, 2010, we received our notification from the IRS that we were successfully registered. On October 15, 2010 the IRS Office of Chief Counsel issued an Advice Memorandum concluding that the AFTC and CBPC could be claimed in the same year for different volumes of biofuel.

During the third quarter of 2012, Office of Chief Counsel of the IRS issued a memo advising taxpayers who are eligible for and wish to convert all or a portion of these AFTCs into CBPCs, that certain amounts of the repayment would not be subject to interest. Taxpayers who wish to convert from the AFTC to the CBPC must first repay the AFTC they wish to convert. During the first quarter of 2013, we repaid \$26 million of AFTC and executed a conversion election to claim \$55 million of CBPC (\$33 million after-tax). The repayment of the AFTC resulted in \$26 million of other operating loss in the Consolidated Statements of Earnings and Comprehensive Income for the first quarter of 2013 and an \$8 million tax benefit related to the reversal of previously unrecognized tax benefits associated with the \$26 million of AFTC that we repaid. The deadline for converting AFTC to CBPC was March 15, 2013.

As of September 30, 2013, we have gross unrecognized tax benefits and interest of \$193 million and related deferred tax assets of \$18 million associated with the AFTC claimed on our 2009 tax return. The recognition of these benefits, \$175 million net of deferred taxes, would impact the effective tax rate. During the second quarter of 2012, the IRS began an audit of our 2009 U.S. income tax return and in the third quarter of 2013 expanded the audit period to include the tax returns for the 2010 and 2011 tax years. The completion of the audit by the IRS or the issuance of authoritative guidance could result in the release of the provision or settlement of the liability in cash of some or all of these previously unrecognized tax benefits. We reasonably expect that the audit settlement, which could happen within the next 12 months, may result in a significant change to the amount of unrecognized tax benefits. However, audit outcomes and the timing of audit settlements are subject to significant uncertainty.

### *Closure and Restructuring*

During the third quarter of 2013, we incurred nil of closure and restructuring costs compared to \$2 million in the third quarter of 2012. During the first nine months of 2013, we incurred \$10 million of closure and restructuring costs compared to \$2 million in the first nine months of 2012.

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

## Edgar Filing: Domtar CORP - Form 10-Q

For more details on the closure and restructuring costs, refer to the Executive Summary of this MD&A or to Item I, Financial Statement and Supplementary Data, Note 12, Closure and Restructuring Costs and Liability and Impairment of Property, Plant and Equipment, of this Form 10-Q.

**Table of Contents****PERSONAL CARE**

SELECTED INFORMATION (In millions of dollars)	Three months ended		Nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Sales	\$ 175	\$ 111	\$ 394	\$ 288
Operating income	11	12	34	32

**Sales and Operating Income***Sales*

Sales in our Personal Care segment amounted to \$175 million in the third quarter of 2013, an increase of \$64 million, when compared to sales of \$111 million in the third quarter of 2012. This increase is due primarily to the inclusion of AHP for a full quarter in the third quarter of 2013, following its acquisition on July 1, 2013.

Sales in our Personal Care segment amounted to \$394 million in the first nine months of 2013, an increase of \$106 million, when compared to sales of \$288 million in the first nine months of 2012. This increase is due primarily to the inclusion of a full quarter of sales of AHP in the first nine months of 2013 compared to the first nine months of 2012 as well as the inclusion of a full nine months of sales of Attends Europe in the first nine months of 2013 compared to the inclusion of seven months in the first nine months of 2012 and the inclusion of a full nine months of sales of EAM in the first nine months of 2013 compared to the inclusion of five months in the first nine months of 2012.

*Operating Income*

Operating income amounted to \$11 million in the third quarter of 2013, a decrease of \$1 million, when compared to operating income of \$12 million in the third quarter of 2012. This decrease is mostly due to higher selling, general and administrative expenses (\$5 million), mainly due to the creation of our new divisional head office in Raleigh, North Carolina when compared to the third quarter of 2012, as well as an increase in the cost of raw materials (\$1 million). These increases were partially offset by the inclusion of results for a full quarter of AHP in the third quarter of 2013 and an increase in higher margin product mix (\$3 million) when compared to the third quarter of 2012.

Operating income amounted to \$34 million in the first nine months of 2013, an increase of \$2 million, when compared to operating income of \$32 million in the first nine months of 2012. This increase is mainly due to the inclusion of a full nine months of Attends Europe in the first nine months of 2013 compared to the inclusion of seven months in the first nine months of 2012 and the inclusion of a full nine months of EAM in the first nine months of 2013 compared to the inclusion of five months in the first nine months of 2012. This increase was partially offset by higher selling, general and administrative expenses, mostly due to the creation of our new divisional head office in Raleigh, North Carolina (\$6 million) as well as an increase in restructuring charges (\$1 million) when compared to the first nine months of 2012.

**Operations***Acquisition of Associated Hygienic Products LLC ( AHP )*

On July 1, 2013, we completed the acquisition of 100% of the outstanding shares of AHP. AHP manufactures and markets infant diapers in the United States. AHP has approximately 600 employees and operates two manufacturing facilities, a 376,500 square foot manufacturing facility in Delaware, Ohio and a 312,500 square foot manufacturing facility in Waco, Texas. The results of AHP's operations are included in the Personal Care reportable segment starting July 1, 2013. The purchase price was \$276 million in cash, including working capital, net of cash acquired of \$2 million. For more details, refer to Note 3 Acquisition of Businesses of this Form 10-Q.



**Table of Contents**

*Labor*

We employ approximately 1,403 employees in our Personal Care segment. Approximately 941 non-unionized employees are in North America, including 543 employees at AHP, and 61 employees at EAM, and 462 employees are in Europe of which the majority are unionized.

## **Table of Contents**

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

For the third quarter of 2013 and the first nine months of 2013, compensation expense of \$6 million was incurred for all outstanding awards recognized in our results of operations, as a result of the mark-to-market impact related to the liability awards. This compares to \$4 million and \$16 million in the third quarter and the first nine months of 2012, respectively. Compensation costs for performance awards are based on management's best estimate of the final performance measurement.

### **LIQUIDITY AND CAPITAL RESOURCES**

Our principal cash requirements are for ongoing operating costs, pension contributions, working capital and capital expenditures, as well as principal and interest payments on our debt. We expect to fund our liquidity needs primarily with internally generated funds from our operations and, to the extent necessary, through borrowings under our contractually committed credit facility, of which \$596 million is currently undrawn and available or through our receivables securitization facility, of which \$98 million is currently undrawn and available. Under adverse market conditions, there can be no assurance that these agreements will be available or sufficient. See "Capital Resources" below.

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

#### **Operating Activities**

Cash flows provided from operating activities totaled \$287 million in the first nine months of 2013, a \$124 million decrease compared to cash flows provided from operating activities of \$411 million in the first nine months of 2012. This decrease in cash flows provided from operating activities is primarily due to decreased profitability in the first nine months of 2013 when compared to the first nine months of 2012 (\$127 million). The nine months ended September 30, 2013 included the litigation settlement with George Weston Limited for \$49 million (\$46 million after tax) and a net benefit related to the conversion of AFTC to CBPC (\$15 million net income benefit). These decreases were partially offset by the premium paid on the redemption of the 5.375% Notes due 2013 in the first nine months of 2013 which was \$45 million (\$28 million after tax) lower than the tender premiums paid on the partial repurchase of our 5.375% Notes due 2013, 7.125% Notes due 2015, 9.5% Notes due 2016 and 10.75% Notes due 2017 in the first nine months of 2012. In addition to lower premiums paid, we consumed less cash from lower working capital requirements.

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

#### **Investing Activities**

Cash flows used for investing activities in the first nine months of 2013 amounted to \$413 million, a \$56 million decrease compared to cash flows used for investing activities of \$469 million in the first nine months of 2012. This decrease in cash flows used for investing activities is due to an increase in proceeds from disposals of \$55 million mainly due to the sale of our Ariva U.S. business (\$45 million) and by the proceeds from sale on the disposal of Port Edwards assets (\$9 million), both in the first nine months of 2013. The acquisition of Attends Europe in the first quarter of 2012 for \$232 million (\$173 million) and EAM for \$61 million in the second quarter of 2012 was mostly offset by the acquisition of AHP in the third quarter of 2013 (\$276 million). In addition, we invested \$1 million in our joint venture in the first nine months of 2013 compared to \$5 million in the first nine months of 2012. These decreases were partially offset by an increase in additions to property, plant and equipment of \$9 million due mainly to increased spending in our Personal Care segment for additional production lines and in our Pulp and Paper segment for upgrades and modifications to our existing assets.

#### **Financing Activities**

Cash flows used for financing activities totaled \$343 million in the first nine months of 2013, compared to cash flows provided from financing activities of \$207 million in the first nine months of 2012. This \$550 million increase in cash flows used for financing activities is mainly attributable to the issuance of \$300 million of 4.4% Notes due 2022 and issuance of \$250 million of 6.25% Notes due 2042 in the first nine months of 2012 and is offset by the impact of the cash tender offer during the first nine months of 2012. In the 2012 tender offer, we repurchased \$1 million of 5.375% Notes due 2013, \$47 million of 7.125% Notes due 2015, \$31 million of 9.5% Notes due 2016 and \$107 million of 10.75%



## Edgar Filing: Domtar CORP - Form 10-Q

Notes due 2017, for a total cash consideration of \$186 million, excluding accrued and unpaid interest. This compares to the redemption of the 5.375% Notes due 2013 in the first quarter of 2013 for \$71 million. We also repurchased shares of our common stock for \$183 million in the first nine months of 2013 compared to \$116 million in the first nine months of 2012, we also made dividend payments of \$50 million in the first nine months of 2013 compared to \$42 million in the first nine months of 2012. Further, we repaid \$28 million of capital leases relating to land and buildings in the first nine months of 2013 compared to \$5 million in the first nine months of 2012 and decreased bank indebtedness by \$21 million in the first nine months of 2013 when compared to the first nine months of 2012.

## **Table of Contents**

### **Capital Resources**

#### *Unsecured Notes Redemption*

During the first quarter of 2013, we redeemed our outstanding 5.375% Notes due 2013, for par value of \$71 million and incurred \$2 million of premiums paid and additional charges of \$1 million, included in Interest expense on the Consolidated Statement of Earnings and Comprehensive Income.

As a result of a cash tender offer in the first quarter of 2012, we repurchased \$1 million of 5.375% Notes due 2013, \$47 million of 7.125% Notes due 2015, \$31 million of 9.5% Notes due 2016 and \$107 million of the 10.75% Notes due 2017 for a total cash consideration of \$186 million. We incurred \$47 million of tender premiums and additional charges of \$3 million as a result of this extinguishment, both of which are included in Interest expense in the Consolidated Statements of Earnings and Comprehensive Income.

#### *Senior Notes Offering*

On August 20, 2012, we issued \$250 million of 6.25% Notes due 2042, for net proceeds of \$247 million. The net proceeds from the offering of the notes were placed in short-term investment vehicles before being used for general corporate purposes.

On March 7, 2012, we issued \$300 million of 4.4% Notes due 2022, for net proceeds of \$297 million. The net proceeds from the offering of the notes were used to fund a portion of the purchase of the 5.375% Notes due 2013, 7.125% Notes due 2015, 9.5% Notes due 2016 and 10.75% Notes due 2017 tendered and accepted by us pursuant to a tender offer, including the payment of accrued interest and applicable early tender premiums, not funded with cash on hand, as well as for general corporate purposes.

The 6.25% Notes due 2042 and 4.4% Notes due 2022 are redeemable, in whole or in part, at our option at any time. In the event of a change in control, each holder will have the right to require us to repurchase all or any part of such holder's notes at a purchase price in cash equal to 101% of the principal amount of the notes, plus any accrued and unpaid interest. The notes are unsecured obligations and rank equally with existing and future unsecured and unsubordinated indebtedness. The notes are fully and unconditionally guaranteed on an unsecured basis by direct and indirect, existing and future, U.S. 100% owned subsidiaries, which currently guarantee indebtedness under the Credit Agreement.

#### *Bank Facility*

On June 15, 2012, we amended and restated our existing Credit Agreement (the "Credit Agreement"), among us, certain subsidiary borrowers, certain subsidiary guarantors and the lenders and agents party thereto. The Credit Agreement amended our existing \$600 million revolving credit facility that was scheduled to mature June 23, 2015.

The Credit Agreement provides for a revolving credit facility (including a letter of credit sub-facility and a swingline sub-facility) that matures on June 15, 2017. The maximum aggregate amount of availability under the revolving Credit Agreement is \$600 million, which may be borrowed in U.S. Dollars, Canadian Dollars (in an amount up to the Canadian Dollar equivalent of \$150 million) and Euros (in an amount up to the Euro equivalent of \$200 million). Borrowings may be made by us, by our U.S. subsidiary Domtar Paper Company, LLC, by our Canadian subsidiary Domtar Inc. and by any additional borrower designated by us in accordance with the Credit Agreement. We may increase the maximum aggregate amount of availability under the revolving Credit Agreement by up to \$400 million, and the Borrowers may extend the final maturity of the Credit Agreement by one year, if, in each case, certain conditions are satisfied, including (i) the absence of any event of default or default under the Credit Agreement and (ii) the consent of the lenders participating in each such increase or extension, as applicable.

Borrowings under the Credit Agreement will bear interest at a rate dependent on our credit ratings at the time of such borrowing and will be calculated at the Borrowers' option according to a base rate, prime rate, LIBO rate, EURIBO rate or the Canadian bankers' acceptance rate plus an applicable margin, as the case may be. In addition, we must pay facility fees quarterly at rates dependent on our credit ratings.

## **Table of Contents**

The Credit Agreement contains customary covenants, including two financial covenants: (i) an interest coverage ratio, as defined in the Credit Agreement, that must be maintained at a level of not less than 3 to 1 and (ii) a leverage ratio, as defined in the Credit Agreement that must be maintained at a level of not greater than 3.75 to 1. At September 30, 2013, we were in compliance with our covenants, and no amounts were borrowed (September 30, 2012 – nil). At September 30, 2013, we had outstanding letters of credit amounting to \$4 million under this credit facility (September 30, 2012- \$12 million). We had \$596 million available under our credit facility at September 30, 2013.

All borrowings under the Credit Agreement are unsecured. However, almost all of our domestic subsidiaries unconditionally guarantee any obligations from time to time arising under the Credit Agreement, and certain of our subsidiaries that are not organized in the United States unconditionally guarantee any obligations of Domtar Inc., the Canadian subsidiary borrower, under the Credit Agreement, in each case, subject to the provisions of the Credit Agreement.

If there is a change of control, as defined under the Credit Agreement, the Credit Agreement will be terminated and any outstanding obligations under the Credit Agreement will automatically become immediately due and payable.

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

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

### *Receivables Securitization*

We have a receivables securitization facility that matures in March 2016, with a utilization limit for borrowings or letters of credit of \$144 million at September 30, 2013. This was extended in the first quarter of 2013 from the prior maturity date of November 2013.

At September 30, 2013, we had no borrowings and \$46 million of letters of credit under the facility (September 30, 2012 – \$46 million). We had \$98 million available under our facility at September 30, 2013. The facility contains certain termination events, which include, but are not limited to, matters related to receivable performance, certain defaults occurring under the credit facility, and certain judgments being entered against us or our subsidiaries that remain outstanding for 60 consecutive days.

### *Domtar Canada Paper Inc. Exchangeable Shares*

Upon the consummation of a series of transactions whereby the Fine Paper Business of Weyerhaeuser Company was transferred to us and we acquired Domtar Inc. on March 7, 2007 (the Transaction), Domtar Inc. shareholders had the option to receive either common stock of the Company or shares of Domtar (Canada) Paper Inc. that are exchangeable for common stock of the Company. As of September 30, 2013, there were 584,214 exchangeable shares issued and outstanding. The exchangeable shares of Domtar (Canada) Paper Inc. are intended to be substantially the economic equivalent to shares of the Company's common stock. These shareholders may exchange the exchangeable shares for shares of Domtar Corporation common stock on a one-for-one basis at any time. The exchangeable shares may be redeemed by Domtar (Canada) Paper Inc. on a redemption date to be set by the Board of Directors, which cannot be prior to July 31, 2023, or upon the occurrence of certain specified events, including, upon at least 60 days prior written notice to the holders, in the event less than 416,667 exchangeable shares (excluding any exchangeable shares held directly or indirectly by us) are outstanding at any time.

## **OFF BALANCE SHEET ARRANGEMENTS**

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

## Edgar Filing: Domtar CORP - Form 10-Q

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 September 30, 2013, we are unable to estimate the potential maximum liabilities for these types of indemnification guarantees as the amounts are contingent upon the outcome of future events, the nature and likelihood of which cannot be reasonably estimated at this time. Accordingly, no provision has been recorded. These indemnifications have not yielded significant expenses in the past.

## **Table of Contents**

### **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 September 30, 2013, we have not recorded a liability associated with these indemnifications, as we do not expect to make any payments pertaining to these indemnifications.

### **ACCOUNTING CHANGES IMPLEMENTED**

#### *Comprehensive Income*

In February 2013, the FASB issued Accounting Standards Update ( ASU ) 2013-02, an update to Comprehensive Income, which requires an entity to provide information regarding the amounts reclassified out of accumulated other comprehensive income by component. The standard requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source, and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, companies would instead cross reference to the related footnote for additional information. We adopted the new requirement on January 1, 2013 with no impact on our consolidated financial statements except for the change in presentation.

We have chosen to present the new information as a separate disclosure in the notes to the consolidated financial statements.

### **FUTURE ACCOUNTING CHANGES**

#### *Foreign Currency Matters*

In March 2013, the FASB issued ASU 2013-05, an update to Foreign Currency Matters, which indicates that a cumulative translation adjustment is attached to the parent's investment in a foreign entity and should be released in a manner consistent with the derecognition guidance on investments in entities. Thus, the entire amount of the cumulative translation adjustment associated with the foreign entity would be released when there has been (i) a sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in the foreign entity; (ii) a loss of a controlling financial interest in an investment in a foreign entity; or (iii) a step acquisition for a foreign entity. The update does not change the requirement to release a pro-rata portion of the cumulative translation adjustment of the foreign entity into earnings for a partial sale of an equity method investment in a foreign entity.

The amendments are effective for interim and annual periods beginning after December 15, 2013 and will not have an impact on our consolidated financial statements unless one or more of the derecognition events stated above occur after the effective date.

#### *Income Taxes*

In July 2013, the FASB issued ASU-2013-11, an update to Income Taxes, which provides additional guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists to eliminate diversity in practice resulting from a lack of guidance. The FASB supports the presentation of the unrecognized tax benefit as a reduction of deferred tax assets. The amendments are effective for interim and annual periods beginning after December 15, 2013. Other than the change in presentation, we have determined these changes will not have an impact on the consolidated financial statements.

## **Table of Contents**

### **CRITICAL ACCOUNTING POLICIES**

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

Critical accounting policies reflect matters that contain a significant level of management estimates about future events, reflect the most complex and subjective judgments, and are subject to a fair degree of measurement uncertainty. There has not been any material change to our policies since December 31, 2012. For more details on critical accounting policies, refer to our Annual Report on Form 10-K for the year ended December 31, 2012.

### **FORWARD-LOOKING STATEMENTS**

The information included in this Quarterly Report on Form 10-Q may contain forward-looking statements relating to trends in, or representing management's beliefs about, Domtar Corporation's future growth, results of operations, performance and business prospects and opportunities. These forward-looking statements are generally denoted by the use of words such as anticipate, believe, expect, intend, aim, target, plan, continue, estimate, project, may, will, should and similar expressions. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to known and unknown risks and uncertainties and other factors that could cause actual results to differ materially from historical results or those anticipated. Accordingly, no assurance 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 wood fiber, chemical and energy;

conditions in the global capital and credit markets, and the economy generally, particularly in the United States, Canada, Europe and China;

performance of the 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;

## Edgar Filing: Domtar CORP - Form 10-Q

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

transportation costs;

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

legal proceedings;

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

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

the effect of timing of retirements and changes in the market price of the 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, 2012.

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

## **Table of Contents**

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

Information relating to quantitative and qualitative disclosure about market risk is contained in our Annual Report on Form 10-K for the year ended December 31, 2012. There has not been any material change in our exposure to market risk since December 31, 2012. A full discussion on Quantitative and Qualitative Disclosure about Market Risk, is found in Note 4 Derivatives and Hedging Activities and Fair Value Measurement, to 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 September 30, 2013, 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 September 30, 2013, 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**

#### **E.B. Eddy Acquisition**

On July 31, 1998, Domtar Inc. (now a 100% owned subsidiary of Domtar Corporation) acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. ( E.B. Eddy ), an integrated producer of specialty paper and wood products. The purchase agreement included a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of Domtar Inc. in specified circumstances, Domtar Inc. may be required to pay an increase in consideration of up to a maximum of \$114 million (CDN\$120 million), an amount gradually declining over a 25-year period. At March 7, 2007, the maximum amount of the purchase price adjustment was \$104 million (CDN\$110 million).

On March 14, 2007, we received a letter from George Weston Limited (the previous owner of E.B. Eddy and a party to the purchase agreement) demanding payment of \$104 million (CDN\$110 million) as a result of the consummation of the series of transactions whereby the Fine Paper Business of Weyerhaeuser Company was transferred to us and we acquired Domtar Inc. on March 7, 2007 (the Transaction ). On June 12, 2007, an action was commenced by George Weston Limited against Domtar Inc. in the Superior Court of Justice of the Province of Ontario, Canada, claiming that the consummation of the Transaction triggered the purchase price adjustment and sought a purchase price adjustment of \$104 million (CDN\$110 million) as well as additional compensatory damages. On June 24, 2013, the parties agreed to settle this litigation with a payment by us to George Weston Limited of \$49 million (CDN \$50 million). The settlement is reflected in Other operating loss, net on the Consolidated Statements of Earnings and Comprehensive Income.

A discussion of other material developments in the Company's litigation and settlement matters occurring in the period covered by this report, if any, is found in Note 16 Commitments and Contingencies, to the financial statements in this Quarterly Report on Form 10-Q.



**Table of Contents****ITEM 1A. RISK FACTORS**

Our Annual Report on Form 10-K for the year ended December 31, 2012, contains important risk factors that could cause our actual results to differ materially from those projected in any forward-looking statement. There were no material changes to the risk factors described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

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

Share repurchase activity under our share repurchase program was as follows during the three-month period ended September 30, 2013:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs (in 000s)
July 1 through July 31, 2013	311,271	\$ 69.93	311,271	\$ 135,957
August 1 through August 31, 2013	188,756	\$ 67.69	188,756	\$ 123,181
September 1 through September 30, 2013	33,300	\$ 65.40	33,300	\$ 121,003
	533,327	\$ 68.85	533,327	\$ 121,003

- (1) During the third quarter of 2013, we repurchased 533,327 shares at an average price of \$68.85 per share, for a total cost of \$36 million under our stock repurchase program (the Program) approved by the Board of Directors in May 2010 and amended in May 2011 and December 2011. We currently have \$121 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 its 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 its stock options, awards, and employee stock purchase plan and to improve shareholders' returns. 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. 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.

---

**Table of Contents**

**ITEM 6. EXHIBITS**

Exhibit 10.1	First Amendment to the Amended and Restated Credit Agreement, dated as of June 15, 2012, among the Company, Domtar Paper Company, LLC, Domtar Inc., Canadian Imperial Bank of Commerce, Goldman Sachs Lending Partners LLC and Royal Bank of Canada, as co-documentation agents, The Bank of Nova Scotia and Bank of America, N.A., as syndication agents and JPMorgan Chase Bank, N.A., as administrative agent (incorporated by reference to Exhibit 10.1 to the Company Form 10-Q files with the SEC on August 3, 2012).
Exhibit 12.1	Computation of Ratio of Earnings to Fixed Charges
Exhibit 31.1	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification by the Chief Executive Officer Pursuant to 18 U.S.C Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase

**Table of Contents**

**SIGNATURE**

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

**DOMTAR CORPORATION**

Date: November 1, 2013

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