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

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

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

OR

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

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

Domtar Inc.

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

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

(Province or other jurisdiction of incorporation or organization)
2621

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

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

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

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

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

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

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

(Title of Class)

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

(Title of Class)

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

o Annual Information form þ Audited annual financial statements

[cover continued on next page]

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

Common Shares 231,576,702 shares

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

Yes o 82-__________ No þ

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

Yes þ No o

FORWARD-LOOKING STATEMENTS

This annual report on Form 40-F/A may contain forward-looking statements relating to trends in, or representing management s beliefs about, Domtar s future growth, results of operations, performance and business prospects and opportunities. These forward-looking statements are generally denoted by the use of words such as anticipate , believe , expect , intend , aim , target , plan , continue , estimate , may , will , should and similar expressions. Th reflect management s current beliefs and are based on information currently available to management.

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

Form 40-F/A

Domtar Inc.

March 21, 2007

TABLE OF CONTENTS

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

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

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

FORWARD-LOOKING STATEMENTS

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

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

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

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

transportation costs;

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

legal proceedings;

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

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

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

performance of pension fund investments and related derivatives; and

the other factors described under Risks and Uncertainties.

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

2006 OVERVIEW

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

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

PROPOSED COMBINATION

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

DISCONTINUED OPERATIONS

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

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

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

FINANCIAL RESULTS OF DISCONTINUED OPERATIONS

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

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

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

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

OUR BUSINESS

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

PAPERS

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

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

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

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

PAPER MERCHANTS

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

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

WOOD

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

SUMMARY OF FINANCIAL RESULTS

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

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

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

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

SPECIFIED ITEMS AFFECTING RESULTS AND NON-GAAP MEASURES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2006 VS 2005 ANNUAL OVERVIEW

SALES OF $4 BILLION

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

OPERATING PROFIT FROM CONTINUING OPERATIONS OF $237 MILLION

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

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

Operating profit from continuing operations in 2006 amounted to $237 million compared to an operating loss from continuing operations of $349 million in 2005. Excluding specified items, operating profit from continuing operations totaled $139 million in 2006 compared to an operating profit from continuing operations of $23 million in 2005. The $116 million increase in operating profit from continuing operations excluding specified items was largely attributable to higher average selling prices for all of our major products except for wood, higher shipments for pulp and paper (excluding the impact of mills that were indefinitely and permanently closed), higher investment tax credits related to research and development expenditures from prior years, the settlement of a sales contract dispute, as well as the realization of savings stemming from restructuring activities. These factors were partially offset by the negative impact of a stronger Canadian dollar (including the effect of our hedging program), lower average selling prices and shipments for wood products and higher energy and freight costs (excluding the impact of mills and sawmills that were permanently or indefinitely closed).

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

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

SPECIFIC COST REDUCTION INITIATIVES

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

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

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

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