restrictions, if any, and other procedures applicable to beneficial interests in such other type of global note for as long as it remains such an interest.

The global notes and any notes issued in exchange therefor will be subject to certain restrictions on transfer set forth in the global notes and in the indenture and will bear the legend regarding such restrictions set forth under the heading "Notice to Investors" below.

You may hold beneficial interests in the global note directly through DTC if you have an account at DTC, or indirectly through organizations that have accounts at DTC.

What is a Global Security? A global security, such as the global note, is a special type of security held in the form of a certificate by a depositary for the investors in a particular issue of securities. The aggregate principal amount of the global security equals the sum of the principal amounts of the issue of securities it represents. The depositary or its nominee is the sole legal holder of the global security. The beneficial interests of investors in the issue of securities are represented in book-entry form in the computerized records of the depositary. If investors want to purchase securities represented by a global security, they must do so through brokers, banks or other financial institutions that have an account with the depositary.

Special Investor Considerations for Global Securities. Because you, as an investor, will not be a registered legal holder of the global note, your rights relating to the global note will be governed by the account rules of your bank or broker and of the depositary, DTC, as well as general laws relating to securities transfers. We will not recognize a typical investor as a legal owner of the notes and instead will deal only with the trustee and DTC, the depositary that is the registered legal holder of the global note.

You should be aware that as long as the notes are issued only in the form of a global security:

- You cannot get the notes registered in your own name.
- You cannot receive physical certificates for your interest in the notes.
- You will not be a registered legal holder of the notes and must look to your own bank or broker for payments on the notes and protection of your legal rights relating to the notes.
- You may not be able to sell interests in the notes to some insurance companies and other institutions that are required by law to own their securities in the form of physical certificates.
- As an owner of beneficial interests in the global note, you may not be able to pledge your interests to anyone who does not have an account with DTC, or to otherwise take actions in respect of your interests, because you cannot get physical certificates representing those interests.
- DTC's policies will govern payments of principal and interest, transfers, exchanges and other matters relating to your interest in the global note. We and the trustee have no responsibility for any aspect of DTC's actions or for its records of ownership interests in the global note. Also, we and the paying agent do not supervise DTC in any way.
- DTC will require that interests in the global note be purchased or sold within its system using same-day funds. Transfers between participants in Euroclear and Clearstream will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Description of DTC. DTC has informed us that:

- DTC is a limited purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the Uniform Commercial Code and a "clearing agency" registered pursuant to the provision of Section 17A of the Securities Exchange Act of 1934.

- DTC was created to hold securities for financial institutions that have accounts with it, and to facilitate the clearance and settlement of securities transactions between the account holders through electronic book-entry changes in their accounts, thereby eliminating the need for physical movement of certificates. DTC account holders include securities brokers and dealers, banks, trust companies and clearing corporations and certain other organizations including Euroclear and Clearstream. Indirect access to the DTC system is also available to banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a DTC account holder, either directly or indirectly.
- DTC's rules are on file with the SEC.
- DTC's records reflect only the identity of the account holder to whose accounts beneficial interests in the global note are credited. These account holders may or may not be the owners of the beneficial interests so recorded. The account holders will be responsible for keeping account of their holdings on behalf of their beneficial owners.

Definitive Notes

In a few special situations described in the next paragraph, the global note will terminate and your interests in it will be exchanged for physical certificates representing the notes. After that exchange, the choice of whether to hold the notes directly or in "street name" (in computerized book-entry form) will be up to you. You must consult your own bank or broker to find out how to have your interests in the notes transferred to your own name, if you wish to be a direct legal holder of the notes.

We will cause definitive notes to be issued in exchange for the global note if DTC notifies us that:

- it is unwilling, unable or no longer qualified to continue acting as the depositary for the global note, or it has ceased to be a clearing agency registered under the Exchange Act at a time when it is required to be so registered, and we do not appoint a successor depositary within 90 days; or
- an event of default with respect to the notes represented by the global note has occurred and is continuing as described under "— Events of Default"; or
- we decide in our sole discretion not to have any of the notes represented by the global note.

We would issue definitive notes in this way:

- in fully registered form;
- without interest coupons; and
- in denominations of multiples of $1,000.

Any definitive notes issued in this way would be registered in the names and denominations requested by DTC.

Payments on the Notes

The Global Note. . The paying agent will make payments of principal of, and interest on, the global note to Cede & Co., the nominee for DTC, as the registered owner. The principal of, and interest on, the notes will be payable in immediately available funds in U.S. dollars.

We understand that it is DTC's current practice, upon DTC's receipt of any payment of principal of, or interest on, global securities such as the global note, to credit the accounts of DTC accounts holders with payment in amounts proportionate to their respective beneficial interests in the principal amount of the global note as shown on the records of DTC. Payments by DTC account holders to owners of beneficial interests in the global note held through these account holders will be the responsibility of the account holders, as is now the case with securities held for the accounts of customers registered in "street name."

Because of time zone differences, the securities account of a Euroclear or Clearstream participant purchasing a security entitlement in a global note from a DTC account holder will be credited, and any such crediting will be reported to the relevant Euroclear or Clearstream participant, during the securities settlement processing day (which must be a business day for Euroclear and Clearstream) immediately following the settlement date of DTC. Cash received in Euroclear or Clearstream as a result of sales of security entitlements in a global note by or through a Euroclear or Clearstream participant to a DTC account holder will be released with a value on the settlement date of DTC but will be available in the relevant Euroclear or Clearstream cash account only as of the business day for Euroclear or Clearstream following DTC's settlement date.

Subject to compliance with the transfer restrictions applicable to the notes, cross-market transfers between the DTC account holders, on the one hand, and Euroclear or Clearstream participants, on the other hand, will be effected through DTC in accordance with DTC's rules on behalf of Euroclear or Clearstream, as the case may be, by its respective depositary; however, such cross-market transactions will require delivery of instructions to Euroclear or Clearstream, as the case may be, by the counterparty in such system in accordance with the rules and procedures and within the established deadlines (Brussels time) of such system. Euroclear or Clearstream, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to its respective depositary to take action to effect final settlement on its behalf by delivering or receiving security entitlements in relevant global notes in DTC, and making or receiving payments in accordance with normal procedures for same-day funds settlement applicable to DTC. Euroclear participants and Clearstream participants may not deliver instructions directly to the depositaries for Euroclear or Clearstream.

Neither we nor the trustee will have any responsibility or liability for any aspect of DTC's, Euroclear's or Clearstream's or their account holders' records relating to, or payments made on account of, beneficial ownership interests in the global note or for maintaining, supervising or reviewing any records relating to these beneficial ownership interests.

Holders of the notes in "street name" and other owners of beneficial interests in the global note should consult their banks or brokers for information on how they will receive payments.

Definitive Notes. Payment of the principal of definitive notes, if any exist, will be made at the office of the paying agent. Payment of the interest on definitive notes will be paid by check mailed to you, if you are a registered holder of the definitive notes. At the request of a registered holder of more than $1,000,000 principal amount of the definitive notes, payments of principal or interest may be made to that holder by wire transfer.

Transfer and Exchange of the Notes

The Global Note. Except as described below, the global note may be transferred, in whole and not in part, only to DTC, to another nominee of DTC or to a successor of DTC or its nominee.

Beneficial Interests in the Global Note. Beneficial interests in the global note will be represented, and transfers of such beneficial interests will be made, through accounts of financial institutions acting on behalf of beneficial owners either directly as account holders, or indirectly through account holders, at DTC. Beneficial interests will be in multiples of $1,000.

Definitive Notes. You may present definitive notes, if any exist, for registration of transfer or exchange at the corporate trust office of the trustee in The City of New York, which we have appointed as the security registrar and transfer agent for the notes.

Same Day Settlement and Payment

Payments with respect to the principal of and interest on, any notes represented by a global note registered in the name of DTC or its nominee on the applicable record date will be payable by the trustee to DTC or, at DTC's discretion, its nominee in its capacity as the registered holder of the global note representing such notes under the indenture. Under the terms of the indenture, we, Bowater, as guarantor of the notes, and the trustee may treat the persons in whose names the notes, including the global notes, are registered as the owners thereof for the purpose of receiving payment thereon and for any and all other purposes whatsoever. Accordingly, none of us, Bowater or the trustee has or will have any responsibility or liability for the payment of such amounts to owners of security entitlements in a global note (including principal and interest). Payments by the DTC participants and the indirect participants to the owners of security entitlements in a global note will be governed by standing instructions and customary industry practice and will be the responsibility of the DTC participants or the indirect participants and DTC.

Transfers between DTC participants in DTC will be effected in accordance with DTC's procedures and will be settled in same-day funds. Transfers between participants in Euroclear or Clearstream, Luxembourg will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Because of time zone differences, the securities account of a Euroclear or Clearstream, Luxembourg participant purchasing a security entitlement in a global note from a DTC participant in DTC will be credited, and any such crediting will be reported to the relevant Euroclear or Clearstream, Luxembourg participant, during the securities settlement processing day (which must be a business day for Euroclear and Clearstream, Luxembourg) immediately following the settlement date of DTC. Cash received in Euroclear or Clearstream, Luxembourg as a result of sales of security entitlements in a global note by or through a Euroclear or Clearstream, Luxembourg participant to a DTC participant in DTC will be received with value on the settlement date of DTC but will be available in the relevant Euroclear or Clearstream, Luxembourg cash account only as of the business day for Euroclear or Clearstream, Luxembourg following DTC's settlement date.

Certificated Notes

With respect to global notes, if (1) we notify the trustee that DTC is no longer willing or able to act as a depositary or DTC ceases to be registered as a clearing agency under the Exchange Act and a successor depositary is not appointed within 90 days of such notice or cessation; or (2) we notify the trustee that we have elected to cause the issuance of certificated notes under the indenture; or (3) upon the occurrence of certain events provided in the indenture, then, upon surrender by DTC of the global notes, certificated notes will be issued to each person that DTC identifies as the owner of a security entitlement in the notes represented by the global notes. Upon any such issuance, the registrar of the notes will be required to register such certificated notes in the name of such person or persons (or any of their nominees) and cause the certificated notes to be delivered to those persons.

None of us, Bowater or the trustee will be liable for any delay by DTC or any DTC participant or indirect participant in identifying the owners of security entitlements in any related notes, and each such person may conclusively rely on and shall be protected in relying on, instructions from DTC for all purposes (including with respect to the registration and delivery, and the respective principal amounts, of the notes to be issued).

UNITED STATES FEDERAL AND CANADIAN INCOME TAX CONSIDERATIONS

The following summaries are of a general nature only and are not intended to be and should not be construed as legal or tax advice to any prospective holders of notes, and no representations with respect to the tax consequences to any particular holder of notes are made hereby. Accordingly, prospective holders of notes should consult with, and rely upon, their own tax advisors for advice with respect to the tax consequences to them of an investment in the notes in light of their own particular circumstances, including any consequences arising under federal, state, provincial and local tax laws of the United States, Canada and any other taxing jurisdiction.

United States Federal Income Tax Consequences

The following is a general discussion of certain of the U.S. federal income tax consequences of the purchase, ownership and disposition of notes. This discussion applies only to beneficial owners of notes that purchase the notes at their "issue price" on the issue date in connection with this offering. Except where noted, this discussion deals only with notes held as capital assets and does not apply to holders that are subject to special tax rules. For example, this discussion does not address:

- tax consequences to holders who may be subject to special tax treatment, such as dealers in securities or currencies, financial institutions, tax-exempt entities, traders in securities that elect to use a mark-to-market method of accounting, corporations that accumulate earnings to avoid federal income tax, insurance companies, or, in some cases, an expatriate of the United States or a nonresident alien individual who has made a valid election to be treated as a United States resident;
- tax consequences to persons holding notes as part of a hedging, integrated, constructive sale or conversion transaction or a straddle;
- tax consequences to U.S. holders of notes whose "functional currency" is not the U.S. dollar;
- alternative minimum tax consequences; or
- any state or local tax consequences.

If you purchase notes at a price other than their issue price, the amortizable bond premium or market discount rules of the U.S. Internal Revenue Code of 1986, as amended, may apply to you. You should consult your tax advisor regarding this possibility.

The discussion below is based upon the provisions of the Internal Revenue Code, existing and proposed regulations promulgated thereunder, and published rulings and judicial decisions, all as of the date of this offering circular. Those authorities may be changed, perhaps retroactively, in which case U.S. federal income tax consequences may be different from those discussed below.

You should consult your own tax advisors concerning the U.S. federal income tax consequences to you of the purchase, ownership, and disposition of notes, and any consequences arising under the tax laws of any state, local or other jurisdiction.

Consequences to United States Holders

The following discussion summarizes certain U.S. federal tax consequences that will apply to you if you are a United States holder of notes. A United States holder means a beneficial owner of a note who or that is:

"United States holder" means a beneficial owner of a note that is:

- a citizen or resident of the United States;
- a corporation or partnership created or organized in or under the laws of the United States or any political subdivision of the United States;
- an estate, the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust that (1) is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons or (2) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

Payments of Interest. Interest on a note will generally be taxable to you as ordinary income at the time it is paid or accrued in accordance with your method of accounting for U.S. federal income tax purposes. The notes are not expected to be issued with "original issue discount" for U.S. federal income tax purposes. In the event we do not comply with certain covenants, we will be obligated to pay specified liquidated damages (in the form of additional interest) to the holders of the notes. We believe that the contingency that we will pay these additional amounts is "remote and incidental" within the meaning of applicable U.S. Treasury regulations. On that basis, we believe that the possibility that these additional amounts may be paid should not be taken into account in computing original issue discount, if any.

The notes will be treated as indebtedness of a U.S. obligor for U.S. federal income tax purposes and, as a result, interest on the notes generally will be treated as U.S. source income. Nonetheless, in the case of a United States holder that is entitled to benefits under the Canada-United States Tax Convention, as currently in effect, interest income on the notes may, subject to certain restrictions and limitations, be treated as foreign source income for purposes of claiming a U.S. foreign tax credit for certain Canadian income taxes, if any, imposed on the holder.

Sale, Exchange and Retirement of Notes. In general, your tax basis in a note will be equal to your cost for that note, reduced by any cash payments on that note other than stated interest. Upon the sale, exchange, retirement or other disposition of a note, you generally will recognize gain or loss equal to the difference between the amount you realize upon the sale, exchange, retirement or other disposition (less an amount equal to any accrued stated interest that you did not previously include in income, which will be taxable as ordinary income) and your adjusted tax basis in the note. That gain or loss will be capital gain or loss and generally will be a U.S. source gain or loss unless it is attributable to an office or other fixed place of business maintained by you outside the United States and certain other conditions are met. Capital gains of individuals derived in respect of capital assets held for more than one year may be eligible for reduced rates of taxation. The deductibility of capital losses is subject to limitations.

Registration Rights. An exchange of the notes for exchange notes pursuant to the registration rights agreement should not be treated as an exchange for United States federal income tax purposes. Therefore, an exchange note should be treated as a continuation of the corresponding note and, as a result, an exchanging United States holder should not recognize any gain or loss on the exchange, its holding period for the exchange would be its holding period for the note, and its basis in the exchange note would be the same as its basis in the note.

Information Reporting and Backup Withholding. In general, information reporting requirements will apply to certain payments of principal and interest on the notes and to the proceeds of sale of the notes unless you are an exempt recipient (such as a corporation). A backup withholding tax at a rate equal to the fourth lowest income tax rate applicable for individuals (which, under current law, is 30.5% for 2001, 30% for 2002 and 2003, 29% for 2004 and 2005, 28% for 2006 and thereafter) will apply to such payments if you fail to provide a correct taxpayer identification number, certified under penalties of perjury, or certification of exempt status, or if you are notified by the Internal Revenue Service that you have failed to report all interest and dividends required to be shown on your U.S. federal income tax returns.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability provided the required information is timely furnished to the IRS.

Consequences to Non-United States Holders

The following is a discussion of certain of the U.S. federal income and estate tax consequences that generally will apply to you if you are a non-United States holder of notes. A non-United States holder is a beneficial owner of notes other than a United States holder.

U.S. Federal Withholding Tax. The 30% U.S. federal withholding tax will not apply to any payment to you of interest on the notes, provided that:

- you do not actually or constructively own 10% or more of the total combined voting power of all classes of our voting stock within the meaning of Section 871(h)(3) of the Code and related U.S. Treasury regulations;
- you are not a controlled foreign corporation that is related, directly or indirectly, to us through stock ownership; and
- (1) you provide your name and address on an IRS Form W-8BEN, and certify, under penalty of perjury, that you are not a U.S. person or (2) you hold your notes through certain foreign intermediaries and you satisfy the certification requirements of applicable U.S. Treasury regulations.

If you do not satisfy the requirements described above, payments of interest made to you will be subject to the 30% U.S. federal withholding tax, unless you provide us with a properly executed (1) IRS Form W-8BEN (or successor form) claiming an exemption from or reduction in the rate of withholding under an applicable tax treaty (in which case interest on the notes will be subject to U.S. federal withholding tax at the applicable treaty rate) or (2) IRS Form W-8ECI (or successor form) stating that interest paid on the notes is not subject to withholding tax because it is effectively connected with your conduct of a trade or business in the United States.

The 30% U.S. federal withholding tax generally will not apply to any payment of principal or any gain that you realize on the sale, exchange, retirement or other disposition of the notes.

U.S. Federal Estate Tax. Your estate will not be subject to U.S. federal estate tax on the notes beneficially owned by you at the time of your death, provided that, at the time of your death (1) you do not own, within the meaning of the Internal Revenue Code and the U.S. Treasury regulations, 10% or more of the total combined voting power of all classes of our voting stock, and (2) interest on the notes would not have been effectively connected with the conduct by you of a trade or business in the United States.

U.S. Federal Income Tax. If you are engaged in a trade or business in the United States and interest on any notes is effectively connected with the conduct of that trade or business, you will be subject to U.S. federal income tax on that interest on a net income basis (although generally exempt from the 30% withholding tax) in the same manner as if you were a U.S. person as defined under the Internal Revenue Code. In addition, if you are a foreign corporation, you may also be subject to a branch profits tax equal to 30% (or lower applicable treaty rate) of your earnings and profits for the taxable year, subject to adjustments, that are effectively connected with the conduct by you of a trade or business in the United States. For this purpose, interest on notes will be included in your earnings and profits.

Any gain or income realized on the disposition of a note generally will not be subject to U.S. federal income tax unless (a) that gain or income is effectively connected with the conduct of a trade or business in the United States by you, or (b) in the case of gain, you are an individual who is present in the United States for 183 days or more in the taxable year of that disposition and certain other conditions are met.

Information Reporting and Backup Withholding. Under U.S. Treasury regulations that became effective for payments made on or after January 1, 2001, backup withholding and information reporting will not apply to payments that we make or any of our paying agents (in its capacity as such) makes to you if you have provided the required certification that you are a non-United States holder and provided that neither we nor any of our paying agents has actual knowledge that you are a United States holder (as described above).

In addition, you will not be subject to backup withholding and information reporting with respect to the proceeds of the sale of a note within the United States or conducted through certain U.S.-related financial intermediaries, if the payor receives the statement described above and does not have actual knowledge that you are a U.S. person, as defined under the Internal Revenue Code, or you otherwise establish an exemption.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability provided the required information is timely furnished to the IRS.

Canadian Federal Income Tax Considerations

General. This summary is of the principal Canadian federal income tax considerations under the Income Tax Act (Canada) and the Income Tax Regulations (which we refer to in this section as the Act and the Regulations, respectively) in effect on the date hereof generally applicable to a beneficial owner (a "Holder") of notes purchased pursuant to this offering circular who, for the purposes of the Act:

- deals with us at arm's-length;
- is neither resident nor deemed to be resident in Canada at any time; and
- holds the notes as capital property and does not use or hold and is not deemed to use or hold the notes in a business that the Holder carries on, or is deemed to carry on, in Canada at any time.

Special rules that are not discussed in this summary may apply to a Holder that is an insurer carrying on business in Canada and in a country other than Canada. This summary is not applicable to a Holder that is a "financial institution," as defined by the Act for purposes of certain rules applicable to income, gain or loss arising from "mark-to-market property."

We have based this summary on the current provisions of the Act and the Regulations, all specific proposals to amend the Act and Regulations publicly announced by or on behalf of the Minister of Finance (Canada) prior to the date of this offering circular and the current published administrative practices and policies of the Canada Customs and Revenue Agency. This summary assumes that the Act and the Regulations will be amended in accordance with the proposals as so announced, although no assurance of that can be given.

This summary is not exhaustive of all possible Canadian federal income tax considerations, and except for the proposed amendments, does not take into account or anticipate any changes in law whether by judicial, governmental or legislative decision or action, nor does it take into account tax legislation or considerations of any province or territory of Canada or any jurisdiction other than Canada. The provisions of provincial income tax legislation vary from province to province in Canada and in some cases differ from federal income tax legislation.

This summary is of a general nature only and is not intended to be, and should not be interpreted as, legal or tax advice to any particular Holder. Accordingly, prospective purchasers of notes are urged to consult their own tax advisors as to the particular tax consequences to them of the purchase, ownership and disposition of the notes.

Canadian Withholding Tax. Subject to the exception in the next paragraph, any amount paid or credited, or deemed to be paid or credited, by a resident of Canada as, on account or in lieu of payment of, or in satisfaction of interest to non-residents of Canada (other than certain persons carrying on business in Canada, to the extent provided in the Act and the Regulations) generally will be subject to a 25% non-resident withholding tax. The rate of such tax may be reduced through the application of international tax treaties or conventions to which Canada is a party, usually to a rate of 10% or 15%.

Generally, interest (other than certain interest described in the Act) payable by a corporation resident in Canada to non-residents of Canada who deal at arm's-length with that corporation on an obligation where the evidence of indebtedness was issued by that corporation after June 23, 1975 is exempt from such withholding tax if under the terms of the obligation or any related agreement, the corporation may not under any circumstances be obliged to pay more than 25% of the principal amount of the obligation (or the aggregate principal amount of a number of obligations, identical in all respects but for their separate principal amounts, that comprise a single debt issue of obligations) within five years from the date of its issue except:

- in the event of a failure or default under such terms or agreement;
- if the terms of the obligation or such agreement become unlawful or are changed by legislation or by a court, statutory board or commission;
- if such a non-resident person exercises a right under the terms of the obligation or such agreement to convert the obligation into, or exchange the obligation for, a "prescribed security" under the Act and the Regulations for this purpose; or
- in the event of the death of the holder of the obligation.

For purposes of the Act and the Regulations, we are treated as a corporation resident in Canada. We believe that interest (including any make-whole premium deemed to be interest) paid or credited (or deemed to be paid or credited for purposes of the Act) on a note to a Holder will be exempt from Canadian withholding tax.

In addition, no other taxes on income (including taxable capital gains) will be payable by a Holder in respect of the acquisition, ownership or disposition of a note.

CERTAIN ERISA CONSIDERATIONS

The following is a summary of certain considerations associated with the purchase of the notes by employee benefit plans that are subject to Title I of the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), plans, individual retirement accounts and other arrangements that are subject to Section 4975 of the Internal Revenue Code or provisions under any federal, state, local, non-U.S. or other laws or regulations that are similar to such provisions of the Internal Revenue Code or ERISA, and entities whose underlying assets are considered to include "plan assets" of such plans, accounts and arrangements.

General Fiduciary Matters

ERISA and the Code impose certain duties on persons who are fiduciaries of a plan subject to Title I of ERISA or Section 4975 of the Internal Revenue Code and prohibit certain transactions involving the assets of a plan and its fiduciaries or other interested parties. Under ERISA and the Code, any person who exercises any discretionary authority or control over the administration of such a plan or the management or disposition of the assets of such a plan, or who renders investment advice for a fee or other compensation to such a plan, is generally considered to be a fiduciary of the plan.

In considering an investment in the notes of a portion of the assets of any plan, a fiduciary should determine whether the investment is in accordance with the documents and instruments governing the plan and the applicable provisions of ERISA, the Internal Revenue Code or any similar law relating to a fiduciary's duties to the plan including, without limitation, the prudence, diversification, delegation of control and prohibited transaction provisions of ERISA, the Internal Revenue Code and any other applicable similar laws. The prudence of a particular investment must be determined by the responsible fiduciary of a plan by taking into account the plan's particular circumstances and all of the facts and circumstances of an investment in a note including, but not limited to, particular risks associated with the investment and the fact that in the future there may be no market in which such fiduciary will be able to sell or otherwise dispose of any notes it may purchase.

Any insurance company proposing to invest assets of its general account in the notes should consider the extent to which such investment would be subject to the requirements of ERISA in light of the U.S. Supreme Court's decision in John Hancock Mutual Life Insurance Co. v. Harris Trust and Savings Bank and under any subsequent legislation or other guidance that has or may become available relating to that decision, including Section 401(c) of ERISA and any regulations thereunder published by the U.S. Department of Labor.

Prohibited Transaction Issues

Section 406 of ERISA and Section 4975 of the Internal Revenue Code prohibit plans subject to Title I of ERISA or Section 4975 of the Internal Revenue Code from engaging in specified transactions involving plan assets with persons or entities who are "parties in interest" within the meaning of ERISA, or "disqualified persons," within the meaning of Section 4975 of the Internal Revenue Code, unless an exemption is available. A party in interest or disqualified person who engaged in a non-exempt prohibited transaction may be subject to excise taxes and other penalties and liabilities under ERISA and the Internal Revenue Code and the transaction must be unwound. In addition, the fiduciary of the plan that engaged in such a non-exempt prohibited transaction may be subject to penalties and liabilities under ERISA and the Internal Revenue Code. The acquisition and/or holding of notes by a plan with respect to which Bowater, our affiliates or one of the initial purchasers is considered a party in interest or a disqualified person may constitute or result in a direct or indirect prohibited transaction under ERISA and/or the Internal Revenue Code, unless the investment is acquired and is held in accordance with an applicable statutory, class or individual prohibited transaction exemption. In this regard, the U.S. Department of Labor has issued prohibited transaction class exemptions, or "PTCEs", that may apply to the acquisition and holding of the notes. These class exemptions include PTCE 84-14 respecting transactions determined by independent qualified professional asset managers, PTCE 90-1 respecting insurance company pooled separate accounts, PTCE 91-38 respecting bank collective investment funds, PTCE 95-60 respecting transactions involving life insurance company general accounts and PTCE 96-23 respecting transactions determined by in-house asset managers. However, there can be no assurance that all of the conditions of any such exemptions will be satisfied, or, if satisfied, that the scope of the relief will cover all acts that might be construed as prohibited transactions.

Because of the foregoing, the notes should not be purchased or held by any person investing "plan assets" of any plan, if such purchase and holding will constitute a non-exempt prohibited transaction under ERISA and the Internal Revenue Code or similar violation of any applicable similar laws whether pursuant to an applicable exemption or otherwise. Each initial investor of a note and each subsequent transferee will, by its purchase and/or holding be deemed to have represented and warranted that (1) it is not a plan, or other entity that is subject to prohibited transaction rules of ERISA, the Code or similar law or (2) its purchase and/or holding of such note will not result in a non-exempt prohibited transaction under Section 406 of ERISA, Section 4975 of the Internal Revenue Code or any similar provisions of similar laws.

The foregoing discussion is general in nature and is not intended to be all-inclusive. Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries, or other persons considering purchasing the notes on behalf of, or with the assets of any plan, consult with their counsel regarding the potential applicability of ERISA, Section 4975 of the Internal Revenue Code and any similar laws to such investment and whether an exemption would be applicable to the purchase and holding of the notes.

UNDERWRITING

We, Bowater and the initial purchasers named below, have entered into a purchase agreement with respect to the notes. Subject to certain conditions, each initial purchaser has severally agreed to purchase the principal amount of notes indicated in the following table.

Initial Purchasers	Principal Amount of Notes
Goldman, Sachs & Co.	$180,000,000
J.P. Morgan Securities Inc.	180,000,000
Banc of America Securities LLC	60,000,000
SunTrust Capital Markets, Inc.	60,000,000
BNY Capital Markets, Inc.	24,000,000
BMO Nesbitt Burns Corp.	24,000,000
First Union Securities, Inc.	24,000,000
Scotia Capital (USA) Inc.	24,000,000
TD Securities (USA) Inc.	24,000,000
Total	$600,000,000

The purchase price for the notes will be the initial offering price set forth on the cover page of this offering circular less a discount of 0.65% of the principal amount of the notes purchased. The initial purchasers propose to offer the notes at the initial offering price. After the notes are released for sale, the initial purchasers may change the offering price and other selling terms.

The notes have not been and will not be registered under the Securities Act. Each initial purchaser has agreed that it will only offer or sell the notes (A) in the United States to qualified institutional buyers in reliance on Rule 144A under the Securities Act, and (B) outside the United States to non-U.S. persons in offshore transactions in reliance on Regulation S under the Securities Act. Terms used above have the meanings given to them by Rule 144A and Regulation S under the Securities Act.

The notes are a new issue of securities with no established trading market. We have been advised by the initial purchasers that they intend to make a market in the notes but they are not obligated to do so and may discontinue any market making at any time without notice. No assurance can be given as to the liquidity of the trading market for the notes.

In connection with the offering, the initial purchasers may purchase and sell the notes in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the initial purchasers of a greater number of the notes than they are required to purchase in the offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the notes while the offering is in progress.

The initial purchasers also may impose a penalty bid. This occurs when a particular initial purchaser repays to the initial purchasers a portion of the underwriting discount received by it because the representatives have repurchased notes sold by or for the account of such initial purchaser in stabilizing or short covering transactions.

These activities by the initial purchasers may stabilize, maintain or otherwise affect the market price of the notes. As a result, the price of the notes may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the initial purchasers at any time. These transactions may be effected in the over-the-counter market or otherwise.

Each initial purchaser has also represented and agreed that: (i) it has not offered or sold, and prior to the six months after the date of the issue of the notes will not offer or sell, any notes to any persons in the United Kingdom, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995; (ii) it has complied, and will comply with, all applicable provisions of the Financial Services Act 1986 of Great Britain with respect to anything done by it in relation to the notes in, from or otherwise involving the United Kingdom; and (iii) it has only issued or passed on and will only issue or pass on in the United Kingdom any document received by it in connection with the issuance of the notes to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996 (as amended) of Great Britain or is a person to whom the document may otherwise lawfully be issued or passed on.

Goldman, Sachs Credit Partners, L.P. and J.P. Morgan Securities, Inc., as lenders under the Bridge Credit Agreement, will receive a portion of the net proceeds of this offering. See "Use of Proceeds." In addition, in the ordinary course of their respective businesses, certain of the initial purchasers and their affiliates have provided, and may in the future provide, investment banking and/or commercial banking services to us.

We and Bowater estimate that our share of the total expense of the offering, excluding underwriting discounts and commissions, will be approximately $1.0 million.

We have agreed to indemnify the initial purchasers against certain liabilities, including liabilities under the Securities Act.

First Union Securities, Inc. ("FUSI"), a subsidiary of Wachovia Corporation, conducts its investment banking, institutional, and capital markets businesses under the trade name of Wachovia Securities. Any references to "Wachovia Securities" in this offering circular, however, do not include Wachovia Securities, Inc., a separate broker-dealer subsidiary of Wachovia Corporation and sister affiliate of FUSI which may or may not be participating as a separate selling dealer in the distribution of the notes.

LEGAL AND TAX MATTERS

Certain legal matters with respect to the notes will be passed upon for us and Bowater by Wendy C. Shiba, Vice President, Secretary and Assistant General Counsel of Bowater, by Ernst & Young LLP (concerning Canadian income tax matters) and by Cox Hanson O'Reilly Matheson (concerning matters of Nova Scotia law). Ms. Shiba owns 2,514 shares of common stock of Bowater, has rights entitling her to certain economic benefits in 19,501.3 shares, and has vested rights to acquire an additional 40,000 shares. Certain legal matters will be passed upon for the initial purchasers by King & Spalding.

INDEPENDENT AUDITORS

The consolidated financial statements of Bowater and its subsidiaries as of December 31, 2000 and 1999 and for each of the years in the three-year period ended December 31, 2000 included in and incorporated by reference in this offering circular have been audited by KPMG LLP, independent accountants, as indicated in their reports with respect thereto.

The consolidated financial statements of Alliance as of December 31, 2000 and 1999 and for each of the years in the three-year period ended December 31, 2000 incorporated by reference in this offering circular have been audited by Raymond Chabot Grant Thornton General Partnership, independent public accountants, as indicated in their reports with respect thereto.

WHERE YOU CAN FIND MORE INFORMATION ABOUT BOWATER INCORPORATED

Bowater files annual, quarterly and current reports, proxy statements and other information with the SEC. Its SEC filings are available over the Internet at the SEC's website at http://www.sec.gov. You may also read and copy any document Bowater files with the SEC at its public reference facilities:

Public Reference Room Office 450 Fifth Street, N.W. Room 1024 Washington, D.C. 20549	Northeast Regional Office 233 Broadway New York, New York 10007	Midwest Regional Office Citicorp Center 500 West Madison Street Suite 1400 Chicago, Illinois 60661-251

You may also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549. Please call 1-800-SEC-0330 for further information on the operations of the public reference facilities. Bowater's SEC filings are also available at the office of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

We "incorporate by reference" in this offering circular the information filed by Bowater with the SEC, which means that we disclose important information to you by referring to those documents. The information incorporated by reference is an important part of this offering circular and information that Bowater subsequently files with the SEC will automatically update and supercede the information in this offering circular and in Bowater's other filings with the SEC. We incorporate by reference the documents listed below, which Bowater has already filed with the SEC, and any future filings Bowater makes with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act until the offering of the Notes contemplated by this offering circular is terminated:

- Bowater's Annual Report on Form 10-K for the year ended December 31, 2000 (including Amendment No. 1 to that report);
- Bowater's Quarterly Reports on Form 10-Q for the quarters ended March 31, 2001 (including Amendment No. 1 to that report) and June 30, 2001;
- Bowater's Current Reports on Form 8-K filed on April 4, 2001, on October 9, 2001 (including Amendment No. 1 to that report filed on October 26, 2001) and on October 23, 2001; and
- The audited consolidated financial statements of Alliance Forest Products Inc. on pages F-1 to F-32 of the prospectus included in Bowater's registration statement on Form S-3 (Registration No. 333-62348).

You may request a copy of these filings, other than an exhibit to a filing, unless that exhibit is specifically incorporated by reference into the filing, at no cost, and a copy of the indenture and the registration rights agreement by writing or calling us at the following address:

Bowater Incorporated
55 East Camperdown Way
Greenville, South Carolina 29602
(864) 271-7733
Attention: Investor Relations Department

If Bowater ceases to be subject to the information requirements of the Exchange Act, we will make available to you and any prospective purchaser of your Notes the information necessary to permit compliance with Rule 144A in connection with resales of your notes.

INDEX TO FINANCIAL STATEMENTS

Unaudited Financial Statements

Audited Financial Statements

BOWATER INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	December 31, 2000	June 30, 2001
	(Unaudited, in millions of US dollars)	
Assets		
Current assets:		
Cash and cash equivalents	$ 20.0	$ 19.7
Marketable securities	0.4	0.4
Accounts receivable, net	380.8	336.1
Inventories	161.9	171.2
Other current assets	52.5	33.0
Total current assets	615.6	560.4
Timber and timberlands	265.2	256.2
Fixed assets, net	2,981.1	2,968.0
Notes receivable	146.0	—
Goodwill	866.8	854.9
Other assets	129.4	150.4
	$5,004.1	$4,789.9
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of long-term debt	$ 141.4	$ 103.9
Short-term bank debt	485.0	489.6
Accounts payable and accrued liabilities	314.7	250.0
Income taxes payable	—	11.6
Dividends payable	10.3	10.1
Total current liabilities	951.4	865.2
Long-term debt, net of current installments	1,304.7	1,228.3
Other long-term liabilities	319.2	224.8
Deferred income taxes	508.1	550.0
Minority interests in subsidiaries	123.6	89.0
Commitments and contingencies	—	—
Shareholders' equity:		
Common stock, issued 62,028,167 and 61,913,626 at June 30, 2001 and December 31, 2000, respectively	61.9	62.0
Exchangeable shares, outstanding and held by non-affiliates 1,199,550 and 1,304,541 at June 30, 2001 and December 31, 2000, respectively	63.5	58.4
Additional paid-in capital	1,367.1	1,373.5
Retained earnings	809.6	845.2
Accumulated other comprehensive income (loss)	(18.0)	(19.5)
Treasury stock, at cost	(487.0)	(487.0)
Total shareholders' equity	1,797.1	1,832.6
	$5,004.1	$4,789.9

See accompanying notes to consolidated financial statements

BOWATER INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CAPITAL ACCOUNTS
For The Six Months Ended June 30, 2001

	Common Stock	Exchangeable Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock
	(Unaudited, in millions of US dollars except per share amounts)					
Balance at December 31, 2000	$61.9	$63.5	$1,367.1	$809.6	$(18.0)	$(487.0)
Net income	—	—	—	56.3	—	—
Retraction of exchangeable shares (104,991 common and exchangeable shares)	0.1	(5.1)	5.0	—	—	—
Dividends ($0.40 per share)	—	—	—	(20.7)	—	—
Stock options exercised (9,550 shares)	—	—	0.2	—	—	—
Tax benefit on exercise of stock options	—	—	0.1	—	—	—
Stock option compensation	—	—	1.1	—	—	—
Pension plan additional minimum liability	—	—	—	—	(0.2)	—
Unrealized gain (loss) on hedged transactions	—	—	—	—	(1.0)	—
Foreign currency translation adjustment	—	—	—	—	(0.3)	—
Balance at June 30, 2001	$62.0	$58.4	$1,373.5	$845.2	$(19.5)	$(487.0)

See accompanying notes to consolidated financial statements

BOWATER INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Six Months Ended	
	June 30, 2000	June 30, 2001
	(Unaudited, in millions of US Dollars)	
Cash flows from operating activities:		
Net income	$ 50.9	$ 56.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and cost of timber harvested	142.3	151.6
Deferred income taxes	16.5	29.8
Minority interests in net income (loss) of subsidiaries	(0.1)	34.3
Net gain on sale of assets	(3.3)	(79.2)
Payments on maturity of hedging contracts	—	(9.3)
Changes in working capital:		
Accounts receivable, net	(40.3)	44.7
Inventories	(8.2)	(9.3)
Accounts payable and accrued liabilities	(19.4)	(47.9)
Income taxes payable	(2.0)	19.8
Other, net	(8.2)	(10.5)
Net cash from operating activities	128.2	180.3
Cash flows from investing activities:		
Cash invested in fixed assets, timber and timberlands	(112.0)	(115.0)
Purchase of assets previously leased	(24.2)	—
Disposition of fixed assets, timber and timberlands	5.2	—
Proceeds from sale of note receivable	—	122.6
Cash paid on maturity of economic hedging contracts	(12.9)	—
Cash invested in marketable securities	(50.7)	—
Cash from maturity of marketable securities	52.5	—
Net cash from (used for) investing activities	(142.1)	7.6
Cash flows from financing activities:		
Cash dividends, including minority interests	(27.7)	(85.6)
Purchase of common stock	(92.1)	—
Short-term financing	279.4	459.2
Short-term financing repayments	(126.3)	(454.6)
Long-term financing	0.4	—
Purchases/payments of long-term debt	(30.9)	(107.4)
Stock options exercised	1.6	0.2
Other	0.8	—
Net cash from (used for) financing activities	5.2	(188.2)
Net decrease in cash and cash equivalents	(8.7)	(0.3)
Cash and cash equivalents at beginning of year	24.7	20.0
Cash and cash equivalents at end of period	$ 16.0	$ 19.7
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest, including capitalized interest of $5.8 and $1.2	$ 67.7	$ 89.9
Income taxes	$ 22.6	$ 13.1

See accompanying notes to consolidated financial statements

BOWATER INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The accompanying consolidated financial statements include the accounts of Bowater Incorporated and Subsidiaries as of June 30, 2001. The consolidated balance sheets, statements of operations, capital accounts and cash flows are unaudited. However, in the opinion of our management, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been made. The results of the interim period ended June 30, 2001 are not necessarily indicative of the results to be expected for the full year.

2. In the second quarter of 2001, Bowater recognized a net pre-tax gain on the sale of assets of $85.0 million. In the fourth quarter of 1999, Calhoun Newsprint Company (CNC), a majority-owned subsidiary of Bowater, sold approximately 140,000 acres of timberlands in North Carolina and South Carolina for proceeds of $173.2 million (before expenses of $1.1 million). CNC received $26.2 million in cash and $145.9 million in notes. We recorded the transaction as an installment sale and had remaining deferred pre-tax gains of approximately $95.0 million. In the second quarter of 2001, we sold the $145.9 million notes receivable for net cash proceeds of $122.6 million, met the requirements for full accrual and recorded a net pre-tax gain of $84.5 million. The net pre-tax gain was comprised of the $95.0 million previously recorded deferred pre-tax gains and a $10.5 million loss on the sale of the notes receivable. The $10.5 million loss on the sale of the notes receivable was based on the original carrying amount of the notes, allocated between the assets sold and the retained interests based on its relative fair value at the date of the transfer. The principle variable in determining the fair value of future expected cash flows of the retained interest is the discount rate as it consists of two individual notes with a low level of credit risk, contractually due in 13.5 years and not subject to prepayment. The discount rates used for the two individual notes were 7.36% and LIBOR plus 0.89, respectively. The retained interest of $12.3 million at June 30, 2001 is included in Other Assets in the consolidated balance sheet. A dividend of $60.1 million was paid to the minority shareholder of CNC.

In April 2001, Bowater reached a final settlement of certain matters regarding the sale of Great Northern Paper, Inc. (GNP) to Inexcon Maine, Inc. (Inexcon). As a result, we recognized a pre-tax charge of $5.8 million, or $.07 per diluted share after tax, in the first quarter of 2001.

During the first six months of 2000, we sold fixed assets resulting in a pre-tax gain of $3.3 million, or $.04 per diluted share after tax.

3. Restructuring and environmental liabilities were recorded in connection with the 1998 acquisition of Avenor Inc., the related closure of the Gold River pulp mill and the sale of the Dryden white paper mill. During the first six months of 2001, we made payments against the reserves of $0.4 million and reduced the reserves by $0.2 million due to foreign exchange.

As of June 30, 2001, the remaining accrual for the above items is $17.2 million. Of this remaining accrual, $3.0 million is included in "Accounts payable and accrued liabilities" and $14.2 million is included in "Other long-term liabilities" in the Consolidated Balance Sheet. As of June 30, 2001, the cash requirements related to these liabilities are expected to be $3.0 million during the balance of 2001 and $14.2 million related to environmental matters in 2002 and beyond.

4. During the first six months of 2001, the Board of Directors of CNC declared dividends of $139.4 million. As a result, $68.3 million was paid to the minority shareholder. In the first six months of 2000, the Board of Directors of CNC declared dividends of $12.5 million, resulting in a payment of $6.1 million to the minority shareholder.

5. Bowater is involved in various legal proceedings relating to contracts, commercial disputes, taxes, environmental issues, employment and workers' compensation claims, and other matters. We periodically review the status of these proceedings with both inside and outside

counsel. Our management believes that the ultimate disposition of these matters will not have a material adverse effect on our operations or our financial condition taken as a whole.

6. No stock purchases were made in the first six months of 2001 under the stock repurchase program authorized in May 1999. During the first six months of 2000, we purchased 1.9 million shares of our common stock for $92.1 million. Since the beginning of this program, we have purchased a total of 3.2 million shares of our common stock at a total cost of $155.5 million.

7. "Other, net" in the Consolidated Statement of Operations includes the following:

	Six Months Ended	
	June 30, 2000	June 30, 2001
	(In millions)	
Foreign exchange loss	$5.3	$ 6.6
Miscellaneous (income) expense	0.5	(0.7)
	$5.8	$ 5.9

Bowater's foreign exchange loss is primarily driven by the revaluation of unhedged foreign denominated liabilities into US dollars plus the ineffective portion of our cash flow hedges.

8. The calculation of basic and diluted earnings per share is as follows:

	Six Months Ended	
	June 30, 2000	June 30, 2001
	(In millions, except per share amounts)	
Basic Computation:		
Net income	$50.9	$56.3
Basic income available to common shareholders	$50.9	$56.3
Basic weighted average shares outstanding	53.0	51.6
Basic earnings per common share	$0.96	$1.09

	Six Months Ended	
	June 30, 2000	June 30, 2001
	(In millions, except per share amounts)	
Diluted Computation:		
Diluted income available to common shareholders	$50.9	$56.3
Basic weighted average shares outstanding	53.0	51.6
Effect of dilutive securities:		
Options	0.5	0.4
Diluted weighted average shares outstanding	53.5	52.0
Diluted earnings per common	$0.95	$1.08

9. Segment Information:

Bowater has three reportable segments: the Newsprint Division, the Coated Paper Division and the Forest Products Division.

- The Newsprint Division is responsible for the manufacturing operations of eight sites in the United States, Canada and South Korea. It is also responsible for the worldwide marketing of newsprint and uncoated groundwood specialties.

- The Coated Paper Division is responsible for one manufacturing site that produces coated groundwood paper, newsprint, market pulp and uncoated groundwood specialties and operates a coating facility, both in the United States. This Division is responsible for the worldwide marketing and sales of coated groundwood paper.
- The Forest Products Division operates three sawmills and manages 1.8 million acres of owned and leased timberlands in the United States and Canada, as well as 14.1 million acres of Crown-owned land in Canada on which we have cutting rights. This Division sells wood fiber to the Newsprint and Coated Paper Divisions, as well as markets and sells timber and lumber to third parties in North America.

The Pulp Division has marketing and sales responsibility for all of our market pulp products; however, the financial results from these sales are included in both the Newsprint Division and the Coated Paper Division, depending upon which site manufactures the product. The Pulp Division's administrative expenses are included in "Corporate & other eliminations." Accordingly, no separate results are reported for this Division.

The following tables summarize information about segment profit and loss and segment assets for the six months ended June 30, 2001 and 2000:

	Six Months Ended June 30, 2001					
	Newsprint Division	Coated Paper Division	Forest Products Division	Other Items	Corporate & Eliminations	Total
Sales — including internal sales	$ 911.9	$255.1	$180.3	$ —	$ —	$1,347.3
Elimination of intersegment sales	—	—	—	—	(157.2)	(157.2)
Sales-including internal sales	911.9	255.1	180.3	—	(157.2)	1,190.1
Segment income (loss)	151.6	22.8	(2.3)	79.2	(22.0)	229.3
Total assets at 6/30/01	$3,441.9	$608.1	$375.5	$ —	$ 364.4	$4,789.9

	Six Months Ended June 30, 2000					
	Newsprint Division	Coated Paper Division	Forest Products Division	Other Items	Corporate & Eliminations	Total
Sales — including internal sales	$ 835.7	$286.1	$220.6	$ —	$ —	$1,342.4
Elimination of intersegment sales	—	—	—	—	(171.9)	(171.9)
Sales-including internal sales	835.7	286.1	220.6	—	(171.9)	1,170.5
Segment income (loss)	102.2	62.3	17.8	3.3	(39.9)	145.7
Total assets at 6/30/00	$3,125.3	$508.2	$507.7	$ —	$ 435.7	$4,576.9

In the second quarter of 2001, Bowater recognized a net pre-tax gain on the sale of assets of $85.0 million. This gain is primarily the result of the sale of a note receivable and recognition of deferred income (previously in Other Long-term Liabilities) related to a 1999 installment sale of timberlands. The pre-tax gain on this sale was $84.5 million ($19.2 million after tax and minority interest). Other net gains on assets sales of $0.5 million were recorded in the second quarter of 2001. In April 2001, Bowater reached a final settlement in connection with the sale of GNP to Inexcon. As a result, we recognized a $5.8 million pre-tax charge in the first quarter of

2001. For the first six months of 2000, the other item relates to a pre-tax gain on sale of fixed assets of $3.3 million.

The line entitled "Segment income (loss)" in the preceding tables is equal to "Operating income" as presented in our Consolidated Statement of Operations. In addition, none of the income/loss items following "Operating income" in our Consolidated Statement of Operations are allocated to our segments, since they are reviewed separately by Bowater's management. These items include, but are not limited to, interest income and expense, provision for income tax expense, and minority interests in net income (loss) of subsidiaries.

10. Effective January 1, 2001, Bowater adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended (SFAS 133). SFAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities and requires that we record all derivatives as either assets or liabilities in the balance sheet at fair value. There were no transition amounts recorded upon the adoption of SFAS 133.

Bowater utilizes certain derivative instruments to enhance its ability to manage risk relating to cash flow exposure. Derivative instruments are entered into for periods consistent with related underlying cash flow exposures and do not constitute positions independent of those positions. We do not enter into contracts for speculative purposes; however, we do have commodity and currency option contracts that are not accounted for as accounting hedges. On the earlier of the date into which the derivative contract is entered or the date of transition, we designate the derivative as a cash flow hedge.

A significant portion of our operating expenses is paid in Canadian dollars at our Canadian mill sites. To reduce our exposure to differences in the US and Canadian dollar exchange rate fluctuations, we enter into and designate Canadian dollar forward contracts to hedge certain of our forecasted Canadian dollar cash outflows at the Canadian mill operations.

Changes in the derivative fair values that are designated effective and qualify as cash flow hedges will be deferred and recorded as a component of "Accumulated other comprehensive income (loss)" until the underlying transaction is recorded in earnings. When the hedged item affects earnings, gains or losses are reclassified from "Accumulated other comprehensive income (loss)" to the Consolidated Statement of Operations on the same line as the underlying transaction (cost of sales). The ineffective portion of a hedging derivative's change in fair value is recognized immediately in earnings.

During the first six months of 2001, we recorded the change in value related to cash flow hedges amounting to a loss of $4.8 million ($3.0 million, after tax) in "Accumulated other comprehensive income (loss)." Of this amount, $3.1 million ($2.0 million, after tax) was reclassified from "Accumulated other comprehensive income (loss)" to earnings, which was offset by net gains on the items being hedged. During the first six months of 2001, with the exception of the time value element of the hedging instruments, amounts that related to the ineffectiveness of our hedging instruments were insignificant. We expect to reclassify a $3.1 million loss ($1.9 million, after-tax) from "Accumulated other comprehensive income (loss)" to earnings during the next twelve months as the hedged items affect earnings.

We formally document all relationships between hedging instruments and hedged items, as well as our risk-management objectives and strategies for undertaking various hedge transactions. We link all hedges that are designated as cash flow hedges to forecasted transactions. The maximum time period we have hedged transactions is two years. We also assess, both at the inception of the hedge and on an on-going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. The change in the time value of the contracts is reported in earnings as exchange gain (loss) and amounted to a loss of $4.5 million ($2.8 million, after tax) in the first half of 2001. When it is determined that a derivative is not highly effective as a hedge, we discontinue hedge accounting prospectively.

At June 30, 2001, we had $688.0 million of Canadian dollar contracts. Information regarding the carrying value, fair market value, and range of exchange rates of the contracts is summarized in the table below:

Foreign Currency Exchange Agreements	Notional Amount of Derivatives	Liability (Asset) Carrying Amount	Liability (Asset) Fair Market Value	Range of US$/Canadian$ Exchange Rates
		(In millions)		
Buy Currency:				
Canadian dollar				
Due in 2001	$193.0	$(0.1)	$(0.1)	.6565–.6546
Due in 2002	357.0	3.1	3.1	.6545–.6524
Due in 2003	138.0	(0.7)	(0.7)	.6524–.6516
Total	$688.0	$ 2.3	$ 2.3	.6565–.6516

We also enter into certain commodity forward contracts that are not designated as accounting hedges. These derivative instruments are primarily intended to reduce volatility of prices for old newsprint and magazines. During the first six months of 2001, an after tax loss of $0.4 million was recognized in earnings relating to these derivatives. At June 30, 2001, we had commodity forward contracts with a notional amount of 21,000 tons of old newspapers and old magazines, a carrying value of $0.3 million and a fair market value of $0.3 million. These commodity forward contracts are due in 2001.

In May 2001, we purchased $250 million of Canadian dollar option contracts to cover the cash portion of consideration to be paid to the shareholders of Alliance Forest Products Inc. (AFP) in connection with the pending acquisition of AFP by Bowater. Related to these options, we paid a premium of $0.6 million, which is being amortized over the life of the options. These options are due in August 2001. Subsequent to June 30, 2001, we settled the Canadian dollar options resulting in a pre-tax loss of approximately $0.4 million.

11. In the Consolidated Balance Sheet as of June 30, 2001, the line entitled "Accumulated other comprehensive income (loss)" includes $(1.7) million for cash flow hedges, $(17.2) million for pension plan additional minimum liabilities, $(8.1) million for foreign currency translation, and $7.5 million for taxes.

12. Certain prior-year amounts in the financial statements and the notes have been reclassified to conform to the 2001 presentation.

13. During the first six months of 2001, Bowater recognized a pre-tax charge of $5.5 million due to pine beetle damage to its woodlands. The continuing drought in the U.S. Southeast is contributing to conditions that allow the southern pine beetle to flourish and expand the range of its infestation. We have incurred pre-tax charges aggregating approximately $13.0 million over the past four quarters as a result of beetle damage. If there is no change in conditions, we may incur additional beetle damage.

14. In April 2001, Bowater announced the signing of a definitive agreement by which Bowater will acquire all of the outstanding shares of Alliance Forest Products Inc. (Alliance). Under the terms of the agreement, Bowater will pay C$13.00 in cash plus 0.166 shares of Bowater stock for each Alliance common share based upon the average trading price for twenty days prior to the agreement, which results in an implied per share value of C$26 for each Alliance common share. The acquisition will be accounted for in accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations" and for accounting purposes, the transaction will be valued based on the price of Bowater's shares a few days before and after the transaction date. Alliance shareholders may choose to receive shares of Bowater common stock or Canadian-listed shares of a Bowater Canadian subsidiary, which are exchangeable, on a one-for-one basis, at any time into Bowater shares. The exchangeable shares have voting and dividend rights substantially equivalent to those of Bowater common shares. The aggregate value of the transaction, including assumed debt, is approximately C$1.2 billion (U.S. $770 million, as of April 2001). The boards of directors of both companies and the shareholders of Alliance have approved the transaction. Approvals have also been received from Canadian regulatory authorities. Bowater is currently responding to the United States Department of Justice's request for additional information. Subject to the expiration or termination of any applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, Bowater now expects to close the purchase near the end of the third quarter of 2001. If the transaction does not close by September 30, 2001, Bowater or Alliance may terminate the transaction without penalty in accordance with the definitive agreement.

MANAGEMENT'S STATEMENT OF RESPONSIBILITY

The management of Bowater is responsible for the information contained in the financial statements and in the other parts of this report. The accompanying consolidated financial statements of Bowater Incorporated and Subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America. In preparing these statements, management has made judgments based upon available information. To ensure that this information will be as accurate and factual as possible, management has communicated to all appropriate employees the requirements for accurate recordkeeping and accounting.

We maintain a system of internal accounting controls designed to provide reasonable assurances for the safeguarding of assets and the reliability of financial records. The system is subject to continuous review through a corporatewide internal audit program with appropriate management follow-up action. Management believes that through the careful selection of employees, the division of responsibilities and the application of formal policies and procedures, we have an effective and responsive system of internal accounting controls.

Our independent auditors, KPMG LLP, are responsible for conducting an audit of our consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and for expressing their opinion as to whether these consolidated financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the company and its subsidiaries in conformity with accounting principles generally accepted in the United States of America. Their report appears on the opposite page.

There is an Audit Committee of the Board of Directors composed of three nonemployee directors who meet regularly with management, the internal auditors and KPMG LLP to discuss specific accounting, reporting and internal control matters. Both the independent auditors and internal auditors have full and free access to the Audit Committee.

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders of Bowater Incorporated:

We have audited the accompanying consolidated balance sheet of Bowater Incorporated and Subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations, capital accounts and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bowater Incorporated and Subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

KPMG LLP
Greenville, South Carolina
February 16, 2001

CONSOLIDATED STATEMENT OF OPERATIONS

	Years ended December 31,		
	1998	1999	2000
	(In millions, except per-share amounts)		
Sales	$2,142.7	$2,311.7	$2,500.3
Cost of sales, excluding depreciation, amortization and cost of timber harvested	1,422.2	1,625.2	1,549.9
Depreciation, amortization and cost of timber harvested	229.6	300.2	295.2
Distribution costs	147.7	177.0	166.6
Selling and administrative expense	82.6	98.7	132.6
Impairment of assets	119.6	92.0	—
Net gain on sale of assets	21.1	225.4	7.3
Operating income	162.1	244.0	363.3
Other expense (income):			
Interest income	(17.5)	(7.7)	(15.6)
Interest expense, net of capitalized interest	98.4	126.7	135.2
Other, net	65.6	(30.8)	4.5
Income before income taxes and minority interests	15.6	155.8	239.2
Provision for income tax expense	25.9	71.5	70.3
Minority interests in net income of subsidiaries	8.2	5.6	9.5
Net income (loss)	(18.5)	78.7	159.4
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustments	(4.1)	2.8	(1.4)
Minimum pension liability adjustments, net of taxes of $0.9, $5.0 and $(6.0), respectively	(9.3)	7.8	1.7
Comprehensive income (loss)	$ (31.9)	$ 89.3	$ 159.7
Earnings per share:			
Basic earnings per common share:			
Net income (loss)	$ (0.44)	$ 1.43	$ 3.05
Average common shares outstanding	47.6	54.2	52.3
Diluted earnings per common share:			
Net income (loss)	$ (0.44)	$ 1.41	$ 3.02
Average common and common equivalent shares outstanding	47.6	55.0	52.8

See accompanying notes to consolidated financial statements.

CONSOLIDATED BALANCE SHEET

	At December 31, 1999	At December 31, 2000
	(In millions, except share amounts)	
Assets		
Current assets:		
Cash and cash equivalents	$ 24.7	$ 20.0
Marketable securities	2.1	0.4
Accounts receivable, net	314.3	380.8
Inventories	145.4	161.9
Other current assets	46.0	52.5
Total current assets	532.5	615.6
Timber and timberlands	283.2	265.2
Fixed assets, net	2,581.3	2,981.1
Notes receivable	146.0	147.1
Goodwill	870.6	866.8
Other assets	138.6	128.3
Total assets	$4,552.2	$5,004.1
Liabilities and shareholders' equity		
Current liabilities:		
Current installments of long-term debt	$ 35.5	$ 141.4
Short-term bank debt	15.0	485.0
Accounts payable and accrued liabilities	336.4	314.7
Dividends payable	10.9	10.3
Total current liabilities	397.8	951.4
Long-term debt, net of current installments	1,454.6	1,304.7
Other long-term liabilities	326.1	319.2
Deferred income taxes	481.4	508.1
Minority interests in subsidiaries	121.5	123.6
Commitments and contingencies	—	—
Shareholders' equity:		
Common stock, $1 par value. Authorized 100,000,000 shares; issued 61,913,626 and 60,828,440 shares at December 31, 2000 and 1999, respectively	60.8	61.9
Exchangeable shares, no par value. Unlimited shares authorized; outstanding and held by non-affiliates 1,304,541 and 2,164,377 at December 31, 2000 and 1999, respectively	105.4	63.5
Additional paid-in capital	1,315.4	1,367.1
Retained earnings	691.8	809.6
Accumulated other comprehensive income (loss)	(18.3)	(18.0)
Loan to ESOT	(0.7)	—
Treasury stock at cost, 11,635,850 and 9,512,499 shares at December 31, 2000 and 1999 respectively	(383.6)	(487.0)
Total shareholders' equity	1,770.8	1,797.1
Total liabilities and shareholders' equity	$4,552.2	$5,004.1

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CAPITAL ACCOUNTS

	Series C Cumulative Preferred Stock	Common Stock	Exchangeable Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Loan to ESOT	Treasury Stock
	(In millions, except share amounts)							
Balance at December 31, 1997	$25.5	$44.9	$ —	$ 563.1	$717.0	$(15.5)	$(4.5)	$(176.3)
Net loss	—	—	—	—	(18.5)	—	—	—
New issuance of stock (12,301,286 common and 3,773,547 exchangeable shares)	—	12.3	183.6	586.4	—	—	—	—
Retraction of exchangeable shares (1,503,022 common shares issued and exchangeable shares retracted)	—	1.5	(73.1)	71.6	—	—	—	—
Debt conversions to exchangeable shares (5,505 shares)	—	—	0.3	—	—	—	—	—
Dividends on:								
Common ($0.80 per share)	—	—	—	—	(38.9)	—	—	—
Series C ($8.40 per share)	—	—	—	—	(2.2)	—	—	—
Reduction in loan to ESOT	—	—	—	—	—	—	1.9	—
Foreign currency translation	—	—	—	—	—	(4.1)	—	—
Stock options exercised (249,800 shares)	—	0.3	—	6.5	—	—	—	—
Tax benefit on exercise of stock options	—	—	—	2.6	—	—	—	—
Pension plan additional minimum liability, net of tax benefit of $6.0	—	—	—	—	—	(9.3)	—	—
Purchase of common stock (2,441,100 shares)	—	—	—	—	—	—	—	(98.1)
Balance at December 31, 1998	$25.5	$59.0	$110.8	$1,230.2	$657.4	$(28.9)	$(2.6)	$(274.4)
Net income	—	—	—	—	78.7	—	—	—
New issuance of exchangeable shares (1,359,620 shares)	—	—	66.2	—	—	—	—	—
Retraction of exchangeable shares (1,471,273 common shares issued and exchangeable shares retracted)	—	1.5	(71.6)	70.1	—	—	—	—
Redemption of Series C preferred stock (264,318 shares)	(25.5)	—	—	—	(0.9)	—	—	—
Dividends on:								
Common ($0.80 per share)	—	—	—	—	(43.3)	—	—	—
Series C ($0.56 per share)	—	—	—	—	(0.1)	—	—	—
Reduction in loan to ESOT	—	—	—	—	—	—	1.9	—
Foreign currency translation	—	—	—	—	—	2.8	—	—
Stock options exercised (375,169 shares)	—	0.3	—	10.4	—	—	—	—
Tax benefit on exercise of stock options	—	—	—	4.7	—	—	—	—
Pension plan additional minimum liability, net of taxes of $5.0	—	—	—	—	—	7.8	—	—
Purchase of common stock (2,468,969 shares)	—	—	—	—	—	—	—	(109.2)
Balance at December 31, 1999	$ —	$60.8	$105.4	$1,315.4	$691.8	$(18.3)	$(0.7)	$(383.6)
Net income	—	—	—	—	159.4	—	—	—
Retraction of exchangeable shares (859,836 common shares issued and exchangeable shares retracted)	—	0.9	(41.9)	41.0	—	—	—	—
Dividends on:								
Common ($0.80 per share)	—	—	—	—	(41.6)	—	—	—
Reduction in loan to ESOT	—	—	—	—	—	—	0.7	—
Foreign currency translation	—	—	—	—	—	(1.4)	—	—
Stock options exercised (225,350 shares)	—	0.2	—	6.6	—	—	—	—
Tax benefit on exercise of stock options	—	—	—	1.9	—	—	—	—
Pension plan additional minimum liability, net of taxes of $0.9						1.7		
Stock option compensation	—	—	—	2.2	—	—	—	—
Treasury stock used for dividend reinvestment plans (2,549 shares)	—	—	—	—	—	—	—	0.3
Purchase of common stock (2,125,900 shares)	—	—	—	—	—	—	—	(103.7)
Balance at December 31, 2000	$ —	$61.9	$ 63.5	$1,367.1	$809.6	$(18.0)	$ —	$(487.0)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Years ended December 31, 1998	1999	2000
		(In millions)	
Cash flows from operating activities:			
Net income (loss)	$ (18.5)	$ 78.7	$ 159.4
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, amortization, and cost of timber harvested	229.6	300.2	295.2
Deferred income taxes	(33.3)	5.5	32.9
Minority interests in net income of subsidiaries	8.2	5.6	9.5
Net gain on sale of assets	(21.1)	(225.4)	(7.3)
Write-down of assets due to impairment	119.6	92.0	—
Write-down of option contracts	22.7	—	—
Reserve for long-term note receivable	15.0	—	—
Changes in working capital:			
Accounts receivable, net	5.2	12.8	(53.6)
Inventories	13.8	5.9	(7.6)
Accounts payable and accrued liabilities	(39.3)	(110.8)	5.1
Income taxes payable	(27.9)	(3.0)	(15.4)
Other, net	0.1	(14.5)	(1.6)
Net cash from operating activities	274.1	147.0	416.6
Cash flows from investing activities:			
Business acquisitions	(876.0)	—	(390.0)
Cash invested in fixed assets, timber and timberlands	(223.2)	(198.5)	(283.2)
Purchase of assets previously leased	—	—	(24.2)
Business dispositions	532.5	108.0	—
Disposition of fixed assets, timber and timberlands	33.8	387.5	7.0
Cash invested in option contracts	(22.7)	—	—
Cash paid on maturity of hedging contracts	(27.9)	(37.4)	(27.7)
Cash invested in marketable securities	(41.9)	(10.6)	(50.7)
Cash from maturity of marketable securities	217.4	9.7	52.5
Net cash from (used for) investing activities	(408.0)	258.7	(716.3)
Cash flows from financing activities:			
Cash dividends, including minority interests	(62.1)	(60.6)	(48.3)
Purchase of common stock	(98.1)	(109.2)	(103.7)
Short-term financing	766.3	284.1	979.5
Short-term financing repayments	(560.0)	(479.1)	(509.5)
Long-term financing	—	32.8	0.4
Purchases/payments of long-term debt	(91.1)	(27.6)	(30.9)
Stock options exercised	6.8	10.7	6.8
Redemption of Series C and LIBOR preferred stock	—	(26.4)	—
Redemption of 7.50% Convertible Unsecured Subordinated Debentures	—	(65.9)	—
Other	1.7	1.9	0.7
Net cash from (used for) financing activities	(36.5)	(439.3)	295.0
Net decrease in cash and cash equivalents	(170.4)	(33.6)	(4.7)
Cash and cash equivalents:			
Beginning of year	228.7	58.3	24.7
End of year	$ 58.3	$ 24.7	$ 20.0
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest, including capitalized interest of $3.5, $4.9 and $4.5	$ (82.1)	$(133.6)	$(139.2)
Income taxes	$ (61.6)	$ (51.8)	$ (36.4)
Noncash investing and financing activity:			
Conversion of 7.50% Convertible Unsecured Subordinated Debentures into exchangeable shares	$ —	$ 66.2	$ —

See accompanying notes to consolidated financial statements.

BOWATER INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. ***Summary of Significant Accounting Policies***

Basis of Presentation:

The accompanying consolidated financial statements include the accounts of Bowater Incorporated and Subsidiaries (Bowater). These financial statements are expressed in United States dollars except where noted and have been prepared in accordance with United States generally accepted accounting principles. All consolidated subsidiaries are wholly owned with the exception of the following:

	Percent Ownership
Bowater Maritimes Inc.	67
Calhoun Newsprint Company (CNC)	51
Bowater Mersey Paper Company Ltd.	51

All significant intercompany transactions and balances have been eliminated.

Bowater also has a 40% interest in and is managing partner for an unconsolidated entity, Ponderay Newsprint Company, which is accounted for using the equity method.

Cash Equivalents:

Cash equivalents generally consist of direct obligations of the United States and Canadian governments and their agencies, investment-grade commercial paper and other short-term investment-grade securities with original maturities of three months or less. These investments are stated at cost, which approximates market value.

Marketable Securities:

Marketable securities generally consist of direct obligations of the United States and Canadian governments and their agencies, investment-grade commercial paper and other short-term investment-grade securities with original maturities of greater than three months but less than one year. These investments are considered to be held-to-maturity securities and are, therefore, stated at cost, which approximates market value.

Derivative Financial Instruments:

Bowater manages certain foreign currency risks through the use of derivative financial instruments that may include forward exchange contracts and currency options. For derivative instruments designated as hedges and having a high correlation with the underlying exposures, gains and losses from changes in derivative fair values are deferred. Gains or losses upon settlement of derivative positions when the underlying transaction occurs are recognized in the Consolidated Statement of Operations. For derivative instruments lacking high correlation characteristics necessary to qualify as hedges, gains and losses from changes in derivative fair values are recognized in the Consolidated Statement of Operations upon remeasurement at the close of each reporting period. Amounts receivable or payable from derivative financial instruments would be reported as "Other assets" or "Accounts payable and accrued liabilities" and "Other long-term liabilities" in the Consolidated Balance Sheet. Bowater's derivatives have various terms, none of which exceeds two years. We do not use derivatives for trading purposes.

The Financial Accounting Standards Board (FASB) has issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. This Standard requires a public company to recognize all derivatives as either assets or liabilities in the Statement of Financial Position and measure those instruments at fair value. Bowater adopted this Standard on January 1, 2001. There were no transition amounts recorded upon adoption of the Standard.

Inventories:

Inventories are stated at the lower of cost or market. Cost is determined by using the average cost and last-in, first-out (LIFO) methods.

Timber and Timberlands:

The acquisition cost of land and timber, property taxes, lease payments, site preparation and other costs related to the planting and growing of timber are capitalized. Capitalization policies are consistent prior to and during harvesting. Such costs, excluding land, are charged against revenue at the time the timber is harvested, based upon annually determined depletion rates, and are included in the line titled "Depreciation, amortization and cost of timber harvested" in the Consolidated Statement of Operations. Depletion rates are determined based on the capitalized costs and the total timber volume based on the current stage of the growth cycle.

Fixed Assets and Depreciation:

Fixed assets are stated at cost less accumulated depreciation. Depreciation is computed generally on the straight-line basis. Repairs and maintenance are charged to operations as incurred. Bowater capitalizes interest on borrowings during the construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the useful lives of the assets.

Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of:

Bowater accounts for long-lived assets in accordance with the provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of." This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

Goodwill:

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is amortized on a straight-line basis over the expected period to be benefited and does not exceed 40 years. Bowater assesses the recoverability of this intangible asset by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future net cash flows of the acquired operation. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows using a discount rate reflecting our average cost of funds.

Income Taxes:

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the Consolidated Statement of Operations in the period that includes the enactment date. Bowater has not provided income taxes on the undistributed earnings of certain of its subsidiaries, as it has specific plans for the reinvestment of such earnings.

Foreign Operations:

Financial statements of the majority of Bowater's Canadian and Korean operations are prepared using the United States dollar as their functional currency. Translation of the Canadian and Korean operations, as well as gains and losses from non-United States dollar foreign currency transactions, such as those resulting from the settlement of foreign receivables or payables, are reported in the Consolidated Statement of Operations.

Translation of other foreign operations to United States dollars occurs using the current exchange rate for balance sheet accounts and an average exchange rate for results of operations. Translation gains or losses are recognized as a component of equity in "Accumulated other comprehensive income (loss)."

Stock Options and Other Stock-Based Compensation:

Bowater records stock option compensation on an intrinsic value basis in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." We also provide pro forma disclosures of stock option compensation recorded on a fair value basis in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation."

Pension, Savings and Other Postretirement Plans:

Bowater has contributory and noncontributory pension plans that cover substantially all employees. Our cash contributions to the plans are sufficient to provide pension benefits to participants and meet the funding requirements of ERISA and applicable Pension Benefits Acts in Canada. We also sponsor defined benefit health care and life insurance plans for retirees at certain locations. Net periodic costs are recognized as employees render the services necessary to earn postretirement benefits.

In addition to the pension plans, Bowater sponsors savings plans for substantially all employees. Our contributions to these defined contribution plans are expensed as incurred.

Comprehensive Income (Loss):

Comprehensive income (loss) consists of net income (loss), foreign currency translation adjustments and pension plan additional minimum liability adjustments and is presented in the Consolidated Statement of Operations. At December 31, 2000, "Accumulated other comprehensive income (loss)" includes $(16.9) million for pension plan additional minimum liabilities, $(7.8) million for foreign currency translation and $6.7 million for taxes. At December 31, 1999, "Accumulated other comprehensive income (loss)" includes $(19.5) million for pension plan additional minimum liabilities, $(6.4) million for foreign currency translation and $7.6 million for taxes.

Revenue Recognition:

Bowater ships all products directly from its manufacturing sites to a customer's location or to a customer-designated site. We recognize revenue from product sales when our customers assume risk of ownership. Bowater adopted the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 (the "SAB") regarding revenue recognition. The SAB requires that a company recognize revenue only when all of the following criteria are met: (1) Persuasive evidence of an arrangement exists; (2) Delivery has occurred or services have been rendered; (3) The seller's price to the buyer is fixed or determinable; and (4) Collectibility is reasonably assured. Upon adoption of the SAB, there was no impact on our results of operations or financial condition.

Distribution Costs:

In September 2000, the Emerging Issues Task Force (EITF) issued EITF No. 00-10, "Accounting for Shipping and Handling Fees and Costs". The EITF concluded that all amounts billed to a customer in a sale transaction related to shipping and handling should be classified as revenue. The EITF also concluded that if costs incurred for shipping and handling are significant and are not included in cost of sales, a company should disclose both the amount of such costs and the line item on the income statement that includes these costs. Bowater's shipping and handling costs are classified as distribution costs and presented separately on the consolidated statement of operations. Bowater implemented EITF 00-10 in the fourth quarter of 2000 and reclassified distribution costs from a separate component of net sales to a separate component of operating expenses.

Basic and Diluted Earnings Per Share:

Basic earnings per common share is calculated assuming no dilution. Diluted earnings per common share is computed using the weighted average number of outstanding common shares adjusted for the incremental shares attributed to dilutive common share equivalents (stock options and convertible debt).

Environmental Costs:

Bowater expenses environmental costs related to existing conditions resulting from past or current operations and from which no current or future benefit is discernible. Expenditures that extend the life of the related property are capitalized. We determine our liability on a site-by-site basis and record a liability at the time it is probable and can be reasonably estimated.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions.

BOWATER INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Reclassifications:

Certain prior-year amounts in the financial statements and the notes have been reclassified to conform to the 2000 presentation.

Note 2. ***Business Acquisitions***

The following table summarizes our business acquisitions during the past three years. The cash payments listed are net of cash acquired and include fees and expenses.

	1998	1999	2000
		(In millions)	
Acquisition of Newsprint South paper mill	$ —	$—	$(382.2)
Acquisition of Ignace sawmill	—	—	(4.7)
Investment in PaperExchange.com	—	—	(3.1)
Acquisition of Avenor, net of cash acquired of $118.0	(675.0)	—	—
Acquisition of South Korean newsprint mill	(201.0)	—	—
	$(876.0)	$—	$(390.0)

In August 2000, Bowater completed its acquisition of the Newsprint South, Inc., paper mill (Grenada mill) in Grenada, Mississippi. The total purchase price, including assumed debt of $8.8 million (fair market value of $7.9 million), amounted to $382.2 million. We accounted for the transaction using the purchase method of accounting. Accordingly, the assets and liabilities of the acquired business were included in the Consolidated Balance Sheet, and the operating results were included in the Consolidated Statement of Operations beginning August 2000.

The purchase price of $382.2 million was allocated as follows:

	(In millions)
Current assets	$ 21.6
Timber and timberlands	1.5
Fixed assets	357.5
Goodwill	20.3
Current liabilities	(10.8)
Long-term debt	(7.9)
	$382.2

The following unaudited pro forma consolidated financial results assume the acquisition had occurred on January 1 of the following years:

	1999	2000
	(In millions)	
Sales	$2,430.3	$2,571.4
Net income	73.0	157.0
Diluted earnings per share	$ 1.31	$ 2.97

In November 2000, Bowater acquired the Ignace sawmill, located in northern Ontario, for $4.7 million. We also invested $3.1 million in PaperExchange.com, a global e-business marketplace for the pulp and paper industry, allowing us to offer newsprint for sale over the Internet.

In July 1998, Bowater completed its acquisition of Avenor Inc. (Avenor), a Canadian pulp and paper company. The total purchase price, including assumed debt of approximately $800.0 million, totaled $2.37 billion (C$3.54 billion). We paid cash of $793.0 million and issued 12.3 million common shares and 3.8 million exchangeable shares. We accounted for the transaction using the purchase method of accounting. The operating results of Avenor were included in the Consolidated Statement of Operations for the period beginning July 1998. The purchase price to Avenor shareholders, plus transaction costs and other accrued liabilities, the excess of fair value of liabilities assumed over the historical book value, and the deferred tax effect of applying purchase accounting at July 1998, over the historical net assets of Avenor, was $1,528.6 million.

Also, in July 1998, we completed the purchase of a South Korean newsprint mill for approximately $201.0 million and prepaid a majority of the current accounts payable for approximately $22.0 million. The investment was recorded at cost using the purchase method of accounting.

Note 3. ***Business Dispositions***

The following table summarizes our business dispositions during the past three years. The amounts listed are the net cash proceeds from the various transactions.

	1998	1999	2000
		(In millions)	
Great Northern paper mill	$ —	$108.0	$—
Dryden white paper mill	532.5	—	—
	$532.5	$108.0	$—

In August 1999, we sold Great Northern Paper, Inc. (GNP) to Inexcon Maine, Inc. (Inexcon) for $250.0 million. The proceeds consisted of cash of $108.0 million (net of expenses), a note receivable of $10.0 million and the assumption of certain employee-related liabilities totaling $130.0 million. We recorded a pre-tax loss of $47.1 million. The note receivable plus accrued interest was payable in full one year from date of the sale. At the request of the buyer and other creditors, the note payment of $10.0 million was deferred from August to December 2000. Subsequently, Bowater consented to a revised payment schedule. Principal payments of $1.2 million were received through February 2001.

The following table shows GNP's sales and operating income (loss) included in the Consolidated Statement of Operations for the 12 months ended December 31, 1998 and 1999:

	1998	1999
	(In millions)	
Sales — including internal sales	$526.2	$249.7
Operating income (loss) (1)	$ 41.7	$(11.4)

(1) Operating income (loss) excludes asset impairment charges of $92.0 million and $119.6 million in 1999 and 1998, respectively, and gains from timberland sales totaling $253.7 million in 1999.

In December 2000, Inexcon asserted certain claims against Bowater for indemnification pursuant to the purchase agreement between Inexcon and Bowater. The company is challenging these claims, and the parties have agreed to arbitration, if necessary.

In September 1998, we completed the sale of our Dryden white paper mill and related assets, which were part of the Avenor acquisition, for $532.5 million. Upon acquisition, the Dryden assets were accounted for as assets held for sale. Therefore, no gain or loss was recorded upon the sale of such assets.

Note 4. *Impairment of Assets*

In 1999, Bowater completed the sale of GNP, which consisted of the East Millinocket mill, the Millinocket mill, timberlands and hydro facilities. During the second quarter of 1999, we signed an agreement with Inexcon for the purchase of all of our assets at GNP. This agreement prompted an evaluation of all the assets at GNP in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." Based on the proposed sale, the assets were written down to fair value, and we recorded a pre-tax impairment charge in special items of $92.0 million.

Previously, in 1998, the Millinocket mill assets were reevaluated in accordance with SFAS No. 121. We determined fair value using discounted future net cash flows. Accordingly, in the third quarter of 1998, we recorded a pre-tax impairment charge in special items totaling $119.6 million, consisting of a write-down of fixed assets of $108.8 million, a mill stores inventory reserve of $7.0 million and an increase to other long-term liabilities of $3.8 million.

Note 5. *Net Gain on Sale of Assets*

	1998	1999	2000
		(In millions)	
Gain on sale of timberlands	$21.1	$272.5	$4.1
Gain on sale of fixed assets	—	—	3.2
Loss on sale of GNP	—	(47.1)	—
	$21.1	$225.4	$7.3

During the year 2000, Bowater sold approximately 6,900 acres of timberlands in the southeastern United States for gross proceeds of $4.7 million. We recorded a pre-tax gain of $4.1 million. During the first quarter of 2000, we sold fixed assets resulting in a pre-tax gain of $3.2 million.

In the first quarter of 1999, we sold approximately 981,000 acres of timberlands and a sawmill in Maine for gross proceeds of $216.5 million. We recorded a pre-tax gain of $145.4 million.

In the second quarter of 1999, we sold approximately 650,000 acres of timberlands in Maine for gross proceeds of $150.0 million. We recorded a pre-tax gain of $108.3 million. As part of the sale, approximately $56.0 million of proceeds were received in the form of a long-term note. This note was monetized through a qualified special purpose entity (QSPE), and the cash proceeds of approximately $51.0 million from the monetization are included in "Disposition of fixed assets, timber and timberlands" in the 1999 Consolidated Statement of Cash Flows. Netted in the gain above is a $3.7 million loss based on the present value of discounted future cash flows of our residual interest in the QSPE. Our remaining interest in the QSPE at December 31, 2000, is $2.9 million based on discounted future cash flows. We have also guaranteed a portion of the debt of the QSPE totaling approximately $12.7 million.

In the fourth quarter of 1999, CNC, a majority-owned subsidiary of Bowater, sold approximately 140,000 acres of timberlands in North Carolina and South Carolina for proceeds of $173.2 million (before expenses of $1.1 million). Bowater received $26.2 million in cash and $145.9 million in notes with interest due semi-annually and principal due in November 2014. We recorded the transaction as an installment sale and as of December 31, 1999, recorded a pre-tax gain of $17.4 million. We have deferred pre-tax gains of approximately $95.0 million on this transaction that will be realized in future periods. The gain will be recognized upon either the collection or sale of the notes. Other timberland sales during the year resulted in additional pre-tax gains of $1.4 million.

In August 1999, we sold GNP for $250.0 million. We recorded a pre-tax loss of $47.1 million. Details concerning the sale of GNP are included in Note 3, "Business Dispositions."

During 1998, we sold 26,000 acres of timberlands primarily in South Carolina for gross proceeds of $30.9 million. We recorded a pre-tax gain of $21.1 million.

Note 6. *Other Expense (Income)*

Other expense (income) includes non-operating items. The breakdown of the components of "Other, net" in the Consolidated Statement of Operations for the three years ended December 31, 1998, 1999 and 2000 is as follows:

	1998	1999 (In millions)	2000
Foreign exchange loss (gain)	$29.7	$(33.4)	$3.9
Loss on Canadian option dollar contracts	22.7	—	—
Reserve for a long-term note receivable financing	15.0	—	—
Other	(1.8)	2.6	0.6
	$65.6	$(30.8)	$4.5

Note 7. *Earnings Per Share*

Basic earnings per common share is calculated assuming no dilution. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

The reconciliation between basic and diluted earnings per common share for "Net income (loss)" is as follows:

	1998	1999	2000
	(In millions, except per-share amounts)		
Basic computation:			
Net Income (loss)	$(18.5)	$78.7	$159.4
Less:			
Series C dividends	(2.2)	(0.1)	—
Series C deferred issuance costs	—	(1.0)	—
Basic income (loss) available to common shareholders	$(20.7)	$77.6	$159.4
Basic weighted average shares outstanding	47.6	54.2	52.3
Basic earnings (loss) per common share	$(0.44)	$1.43	$ 3.05
Diluted computation:			
Basic income (loss) available to common shareholders	$(20.7)	$77.6	$159.4
Effect of dilutive securities	—	—	—
Diluted income (loss) available to common shareholders	$(20.7)	$77.6	$159.4
Basic weighted average shares outstanding	47.6	54.2	52.3
Effect of dilutive securities:			
Options	—	0.8	0.5
Diluted weighted average shares outstanding	47.6	55.0	52.8
Diluted earnings (loss) per common share	$(0.44)	$1.41	$ 3.02

The dilutive effect of options outstanding is computed using the treasury stock method. In 2000 and 1999, all options were included in the calculation of diluted earnings per share. Due to the net loss incurred for the year ended December 31, 1998, all common stock equivalents were excluded to prevent antidilution.

Note 8. *Inventories*

	1999	2000
	(In millions)	
At lower of cost or market:		
Raw materials	$ 30.1	$ 39.3
Work in process	3.6	2.8
Finished goods	31.8	44.1
Mill stores and other supplies	88.4	84.0
	153.9	170.2
Excess of current cost over LIFO inventory value	(8.5)	(8.3)
	$145.4	$161.9

Inventories valued using the LIFO method comprised 14.3% and 6.5%, respectively, of total inventories at December 31, 2000 and 1999.

Note 9. *Fixed Assets*

	1999	2000	Range of Estimated Useful Lives In Years
	(In millions)		
Land and land improvements	$ 34.9	$ 37.6	10-20
Buildings	301.0	317.0	20-40
Machinery and equipment	3,899.3	4,373.2	5-20
Leasehold improvements	2.7	3.2	10-20
Construction in progress	66.6	185.8	—
	4,304.5	4,916.8	
Less accumulated depreciation and amortization	1,723.2	1,935.7	
	$2,581.3	$2,981.1	

Note 10. *Goodwill*

Goodwill consists of an amount recorded with the acquisition of the Grenada operations in August 2000 and the goodwill recorded with the acquisition of Avenor in July 1998. The goodwill purchased with the Grenada operations of $20.3 million is being amortized on a straight-line basis over 20 years. The goodwill acquired with Avenor is being amortized on a straight-line basis over 40 years. Bowater recorded goodwill amortization of $23.8 million in 2000, $22.5 million in 1999 and $9.8 million in 1998. Accumulated amortization of goodwill totaled $56.1 million and $32.3 million at December 31, 2000 and 1999, respectively.

Note 11. *Accounts Payable and Accrued Liabilities*

	1999	2000
	(In millions)	
Trade accounts payable	$158.2	$169.7
Payroll, bonuses and severance	36.6	48.1
Accrued interest	22.1	29.4
Employee benefits	20.4	7.6
Amounts payable under GNP sales agreement	20.0	—
Avenor acquisition/divestiture-related liabilities (See Note 12)	19.1	3.9
Unrealized losses on hedging contracts	19.0	5.6
Property and franchise taxes payable	13.2	13.1
Other	27.8	37.3
	$336.4	$314.7

Note 12. *Avenor Acquisition/Divestiture-Related Liabilities*

In connection with the acquisition of Avenor during the third quarter of 1998, Bowater recorded merger-related liabilities totaling $17.8 million. These liabilities consisted primarily of Avenor employee termination costs, Avenor facility closures and Avenor lease commitments.

Also in the third quarter of 1998, we recorded liabilities of $65.0 million for the closure of our Gold River pulp mill (acquired as part of the Avenor acquisition). Of this 1998 recorded amount, $15.0 million was for environmental obligations with the balance covering asset write-off and employee termination costs. The outstanding environmental obligation at December 31, 2000 was approximately $3.1 million.

During the fourth quarter of 1998, in conjunction with the sale of our Dryden white paper mill (acquired as part of the Avenor acquisition), liabilities were recorded to cover employee termination costs and other costs that we retained as part of the sales agreement. We recorded liabilities totaling $14.8 million related to this transaction.

The total amount of Avenor acquisition/divestiture-related liabilities of $97.6 million was recorded as part of the cost of the acquisition.

During 2000, we netted $2.8 million of our asset impairment reserve against the related assets of the Gold River pulp mill. As of December 31, 2000, the remaining accrual for the above items is $17.8 million. Of this remaining accrual, $3.9 million is included in "Accounts payable and accrued liabilities," and $13.9 million is included in "Other long-term liabilities" in the Consolidated Balance Sheet. As of December 31, 2000, the cash requirements related to these liabilities are expected to be $3.9 million in 2001 and $13.9 million in 2002 and beyond.

The following tables summarize the activity for the liabilities described above:

	Balance, 12/31/99	Reclass Adjustments	Write-offs & Payments Against Reserve	Increase (Decrease) Reserve	Foreign Exchange	Balance, 12/31/00
			(In millions)			
Employee termination costs	$ 3.3	$ —	$(3.2)	$ —	$(0.1)	$ —
Facility closures	3.9	0.4	(0.4)	—	(0.1)	3.8
Asset impairments/disposals	3.6	(2.8)	(0.7)	—	(0.1)	—
Environmental	15.2	(0.4)	(2.4)	2.1	(0.5)	14.0
Totals	$26.0	$(2.8)	$(6.7)	$2.1	$(0.8)	$17.8

	Balance, 12/31/98	Adjust Goodwill	Write-offs & Payments Against Reserve	Increase (Decrease) Reserve	Foreign Exchange	Balance, 12/31/99
			(In millions)			
Employee termination costs	$30.5	$(2.7)	$(22.6)	$(3.7)	$1.8	$ 3.3
Facility closures	5.2	(1.1)	(0.5)	—	0.3	3.9
Asset impairments/disposals	8.1	—	(4.8)	—	0.3	3.6
Environmental	15.7	—	(3.8)	2.5	0.8	15.2
Totals	$59.5	$(3.8)	$(31.7)	$(1.2)	$3.2	$26.0

	Balance, 12/31/97	Establish Reserve	Write-offs & Payments Against Reserve	Increase (Decrease) Reserve	Foreign Exchange	Balance, 12/31/98
			(In millions)			
Employee termination costs	$ —	$39.9	$ (9.5)	$ —	$0.1	$30.5
Facility closures	—	5.1	—	—	0.1	5.2
Asset impairments/disposals	—	36.9	(29.0)	—	0.2	8.1
Environmental	—	15.7	—	—	—	15.7
Totals	$ —	$97.6	$(38.5)	$ —	$0.4	$59.5

Note 13. *Long-Term and Short-Term Debt*

Long-term debt, net of current installments:

	1999	2000
	(In millions)	
Unsecured:		
9.00% Debentures due 2009	$ 250.0	$ 250.0
9.38% Debentures due 2021, net of unamortized discount of $0.9 in 2000 and $1.0 in 1999	198.9	199.0
10.62% Notes due 2010	128.6	126.5
10.50% Notes due at various dates from 2002 to 2010	125.7	112.0
9.50% Debentures due in 2012, net of unamortized discount of $0.3 in 2000 and $0.3 in 1999	124.7	124.7
10.85% Debentures due 2014	120.1	115.7
9.25% Debentures due 2002	64.0	61.7
9.86% Notes due 2001	93.1	—
10.60% Notes due 2011	92.4	91.0
7.75% recycling facilities revenue bonds due 2022	62.0	62.0
7.40% recycling facilities revenue bonds due 2022	39.5	39.5
7.62% recycling facilities revenue bonds due 2016	30.0	30.0
10.26% Notes due at various dates from 2002 to 2011	27.2	26.9
Pollution control revenue bonds due at various dates from 2002 to 2010 with interest at varying rates from 6.85% to 7.62%	23.3	13.4
Industrial revenue bonds due 2029 with interest at floating rates	33.5	33.5
8.50% Notes due 2001	18.1	—
Bank term loan at floating rates due 2001	12.0	—
10.25% Debentures due 2003	7.4	7.4
UDAG loan agreement due 2010 with interest varying rates from 5% to 6.5%	—	7.7
11.00% Subordinated debt due 2003	4.1	3.7
	$1,454.6	$1,304.7

Long-term debt maturities for the next five years are as follows:

Year	Balance Sheet Classification	Amount (In millions)
2001	Current installments of long-term debt	$141.4
2002	Long-term debt, net of current installments	$ 71.9
2003	Long-term debt, net of current installments	$ 24.1
2004	Long-term debt, net of current installments	$ 12.9
2005	Long-term debt, net of current installments	$ 13.6

The debt balances listed above include $113.2 million at December 31, 2000, and $126.9 million at December 31, 1999, due to the revaluation of the debt balances acquired with the purchase of the Newsprint South paper mill in August 2000, and the July 1998 acquisition of Avenor.

In 2000, Bowater increased the amount of its 364-day credit facility from $150.0 million to $750.0 million, while retaining its $350.0 million, five-year facility. Borrowings under these facilities incur interest based, at our option, on specified market interest rates plus a margin tied to the credit rating of our long-term debt. At December 31, 2000, $220.0 million (at 7.3%) was outstanding under the $750.0 million facility, $262.8 million (at 7.6%) was outstanding under the

$350.0 million facility, and $2.2 million was outstanding under an operating line of credit. At December 31, 1999, $15.0 million (at 6.8%) was outstanding under the $750.0 million facility, and there was no balance outstanding under the $350.0 million facility or the operating line of credit.

In January 2000, we repaid $19.8 million of our 9.25% Debentures due 2002. The cash price paid was $20.8 million, including premium and accrued interest. The principal amount was included on the line titled "Current installments of long-term debt" in the Consolidated Balance Sheet at December 1999. In December 1999, we repaid $13.3 million of the same issue. The cash price paid was $13.9 million, including premium and accrued interest.

During 2000 and 1999, Bowater received proceeds totaling $33.5 million from revenue bonds issued by the Industrial Development Board of the County of McMinn, Tennessee, in conjunction with the modernization of its Calhoun, Tennessee, newsprint facility. The bonds are variable rate (5.0% at December 31, 2000, and 5.6% at December 31, 1999) and mature in June 2029.

In February 1999, we redeemed all of our outstanding 7.50% Convertible Unsecured Subordinated Debentures due 2004. In connection with the redemption, we paid cash of $65.9 million, and Bowater Canada Inc. issued 1,359,620 exchangeable shares.

Bowater guarantees certain payments of debt related to its unconsolidated entities. The total amount was $62.7 million at December 31, 2000, and December 31, 1999.

Note 14. ***Financial Instruments***

At December 31, 2000, Bowater had foreign currency forward and range forward contracts with a notional value of $448.0 million maturing through 2002. The notional amount of these contracts represents the amount of foreign currencies to be purchased or sold at maturity and does not represent our exposure on these contracts. The contracts serve as economic hedges against our Canadian operations; however, because the costs hedged are not firm commitments, these contracts are marked to market, with gains and losses recognized in the Consolidated Statement of Operations.

The carrying amounts of our short-term financial assets and liabilities (excluding derivatives) approximate fair value. We estimate the fair value of our long-term debt using rates currently available for debt with similar terms and remaining maturities. The fair value of derivative financial instruments is based on current termination values or quoted market prices of comparable contracts. A summary of our derivative financial instruments and long-term debt at December 31, 1999 and 2000, follows:

	1999			2000		
	Notional Amount of Derivatives	Net Asset (Liability) Carrying Amount	Net Asset (Liability) Fair Value	Notional Amount of Derivatives	Net Asset (Liability) Carrying Amount	Net Asset (Liability) Fair Value
	(In millions)					
Foreign currency exchange Agreements:						
Buy currency:						
Canadian dollar						
Due in 2000	$457.8	$ (19.0)	$ (19.0)	$ —	$ —	$ —
Due in 2001	183.0	(0.7)	(0.7)	363.0	(4.3)	(4.3)
Due in 2002	—	—	—	85.0	1.9	1.9
Long-term debt	$ —	$(1,490.1)	$(1,490.1)	$ —	$(1,446.1)	$(1,468.1)

The counterparties to our derivative financial instruments are substantial and creditworthy multi-national financial institutions. Therefore, the risk of counterparty nonperformance is considered to be remote.

Note 15. ***Pension and Other Nonpension Postretirement Benefits***

Bowater has multiple defined benefit pension plans and other nonpension postretirement plans (the Plan(s)) covering substantially all employees. Benefits are based on years of service and, depending on the Plan, average compensation earned by employees either during their last years of employment or over their careers.

The following tables include both foreign and domestic plans at December 31, 2000 and 1999. The benefit obligations of the Plans outside the United States are significant relative to the total benefit obligation; however, the assumptions used to measure the obligations of those Plans are not significantly different from those used for the United States Plans.

	Pension Plans		Other Postretirement Plans	
	1999	2000	1999	2000
	(In millions)			
Change in benefit obligation:				
Benefit obligation at beginning of year	$1,208.0	$1,218.9	$ 181.6	$ 89.8
Acquisition	—	6.5	—	—
Divestiture	27.8	—	(101.5)	—
Service cost	23.8	21.7	2.9	1.4
Interest cost	78.8	82.9	9.5	6.2
Amendments	3.9	—	1.2	0.8
Special termination benefits	1.6	1.7	—	—
Actuarial (gain) loss	(61.7)	(37.6)	2.9	16.3
Participant contributions	4.7	5.2	0.8	0.3
Benefits paid	(90.7)	(89.6)	(9.1)	(7.2)
Effect of foreign currency exchange rate changes	22.7	(5.9)	1.5	(0.3)
Benefit obligation at end of year	1,218.9	1,203.8	89.8	107.3
Change in Plan assets:				
Fair value of Plan assets at beginning of year	1,073.2	1,198.9	—	—
Acquisition	—	6.3	—	—
Actual return on Plan assets	174.7	149.6	—	—
Employer contributions	18.3	16.8	8.3	6.9
Participant contributions	4.7	5.2	0.8	0.3
Benefits paid	(90.7)	(89.6)	(9.1)	(7.2)
Effect of foreign currency exchange rate changes	18.7	(5.9)	—	—
Fair value of Plan assets at end of year	1,198.9	1,281.3	—	—

	Pension Plans 1999	Pension Plans 2000	Other Postretirement Plans 1999	Other Postretirement Plans 2000
	(In millions)			
Reconciliation of funded status:				
Funded status	(20.0)	77.5	(89.8)	(107.3)
Unrecognized actuarial (gain) loss	(7.0)	(91.5)	3.7	19.7
Unrecognized transition amount	(5.0)	(1.5)	—	—
Unrecognized prior service cost	1.7	1.4	1.4	2.0
Net amount recognized	(30.3)	(14.1)	(84.7)	(85.6)
Amounts recognized in the Consolidated Balance Sheet consist of:				
Prepaid benefit cost	68.6	51.4	—	—
Accrued benefit liability	(119.5)	(83.5)	(84.7)	(85.6)
Intangible asset	1.1	1.1	—	—
Accumulated other comprehensive loss (income)	19.5	16.9	—	—
Net amount recognized	$ (30.3)	$ (14.1)	$ (84.7)	(85.6)
Weighted average assumptions:				
Discount rate	7.0%	7.2%	7.0%	7.2%
Expected return on Plan assets	9.2%	9.2%	—	—
Rate of compensation increase	4.1%	4.2%	4.1%	4.2%

	Pension Plans 1998	Pension Plans 1999	Pension Plans 2000	Other Postretirement Plans 1998	Other Postretirement Plans 1999	Other Postretirement Plans 2000
			(In millions)			
Components of net periodic benefit cost:						
Service cost net of employee contributions	$ 18.1	$ 23.8	$ 21.7	$ 3.5	$ 2.9	$1.4
Interest cost	51.5	78.8	82.9	10.2	9.5	6.2
Expected return on Plan assets	(65.5)	(100.2)	(105.3)	—	—	—
Amortization of transition amount	(3.4)	(3.4)	(3.4)	—	—	—
Amortization of prior service cost	0.6	0.5	0.2	0.3	0.2	0.1
Recognized net actuarial (gain) loss	2.6	4.9	2.9	0.4	0.6	0.1
Curtailment and special termination benefits	—	27.3	1.7	—	—	—
Net periodic benefit cost	$ 3.9	$ 31.7	$ 0.7	$14.4	$13.2	$7.8

In August 2000, Bowater acquired the pension plan covering employees of the Grenada mill. The effect of this plan on the benefit obligation and assets was included in the table above.

In August 1999, Bowater completed the sale of GNP. As a result of the sale, we recorded a curtailment loss of $26.1 million, and the buyer assumed liabilities totaling approximately $70.6 million for nonpension postretirement benefits.

As of December 31, 2000, Bowater increased the Plans' weighted average discount rate from 7.0% to 7.2% to more closely approximate interest rates on high-quality, long-term obligations on the measurement date. In 2000, the assumed inflationary health care cost trend rate used to determine cost was 8.3%, decreasing to 7.8% in 2001 and gradually decreasing to an ultimate rate of 6.0% in 2005. The rate used to determine 1999 cost was 8.3% gradually decreasing to an ultimate rate of 5.8% in 2004. Variations in this health care cost trend rate can have a significant effect on the amounts reported. An increase of 1% in this assumption would increase the accumulated postretirement benefit obligation (APBO) by approximately $14.0 million, or 13%, and would increase the annual service cost and interest cost by approximately $1.1 million, or 14%. A decrease of 1% in this assumption would decrease the APBO by approximately $11.5 million, or 11%, and would decrease the annual service cost and interest cost by approximately $0.9 million, or 12%.

The sum of the projected benefit obligations and the sum of the fair value of Plan assets for pension Plans with projected benefit obligations in excess of plan assets were $274.6 million and $204.6 million, respectively, as of December 31, 2000, and were $518.7 million and $392.9 million, respectively, as of December 31, 1999. The sum of the accumulated benefit obligations and the sum of the fair value of Plan assets for pension Plans with accumulated benefit obligations in excess of Plan assets were $74.6 million and $22.0 million, respectively, as of December 31, 2000, and were $341.0 million and $252.6 million, respectively, as of December 31, 1999.

The provisions of SFAS No. 87, "Employees' Accounting for Pensions," required Bowater to record an additional minimum liability of $18.0 million and $20.6 million at December 31, 2000 and 1999, respectively. This liability represents the amount by which the accumulated benefit obligation exceeds the sum of the fair market value of Plan assets and accrued amounts previously recorded. The additional liability may be offset by an intangible asset to the extent of previously unrecognized prior service cost. The intangible assets of $1.1 million at December 31, 2000 and 1999, are included on the line titled "Other assets" in the Consolidated Balance Sheet. The remaining amounts of $10.2 million and $11.9 million, net of related tax benefits, are recorded as a component of shareholders' equity on the line titled "Accumulated other comprehensive income (loss)" in the Consolidated Balance Sheet at December 31, 2000 and 1999, respectively.

In addition to the previously described pension and nonpension postretirement Plans, we also sponsor defined contribution Plans within the United States and for certain sites outside of the United States. Employees are allowed to contribute to the Plans, and we make a matching contribution between 3.6% and 7.2% of the employees' compensation. Our expense for the defined contribution Plans totaled $5.7 million in 2000, $7.2 million in 1999 and $7.0 million in 1998.

Note 16. ***Income Taxes***

The components of "Income before income taxes and minority interests" consist of United States income (loss) of $84.3 million, $129.1 million and $(17.1) million, and foreign income of $154.9 million, $26.7 million and $32.7 million, in 2000, 1999 and 1998, respectively.

BOWATER INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The provision for income tax expense consists of:

	1998	1999	2000
		(In millions)	
Federal:			
Current	$ 42.3	$45.4	$17.6
Deferred	(49.6)	(.3)	10.9
	(7.3)	45.1	28.5
State:			
Current	10.5	9.2	5.0
Deferred	(6.4)	(1.5)	(8.2)
	4.1	7.7	(3.2)

	1998	1999	2000
		(In millions)	
Foreign:			
Current	6.4	11.4	14.8
Deferred	22.7	7.3	30.2
	29.1	18.7	45.0
Total:			
Current	59.2	66.0	37.4
Deferred	(33.3)	5.5	32.9
	$ 25.9	$71.5	$70.3

components of deferred income taxes at December 31, 1999 and 2000, in the
ng Consolidated Balance Sheet are as follows:

	1999	2000
	(In millions)	
'ands(1)	$ (88.5)	$ (85.0)
	(583.2)	(542.5)
	(2.5)	(18.2)
A	$(674.2)	(645.7)
An	$ 2.9	1.3
Rec	20.8	16.0
(g 'abilities	110.9	105.1
Curtai term	33.1	7.8
	21.0	20.2
Net perio	32.2	8.5
	(4.4)	(4.0)
	216.5	154.9
	$(457.7)	$(490.8)

of United
income of

In August 2
The effect of this

In August 199
curtailment loss of
$70.6 million for non

on of lease payments, management fees
on and $113.1 million at December 31, 2000

As of December 3
from 7.0% to 7.2% to m
obligations on the measu

ompanying Consolidated Balance Sheet.

As of December 31, 2000, $3.7 million of the valuation allowance is attributable to the acquisition of Avenor and will reduce goodwill upon reversal.

The following is a reconciliation of the United States federal statutory and effective tax rates as a percentage of income before income taxes and minority interests:

	1998	1999	2000
United States federal statutory Income tax rate	35.0%	35.0%	35.0%
State income taxes, Net of federal Income tax benefit	17.3	3.2	(1.9)
Foreign taxes	87.8	0.9	2.4
Goodwill (1)	24.4	5.1	3.4
Canadian investment tax credits	—	—	(3.2)
Foreign exchange and asset revaluation	—	—	(6.3)
Other, net	1.5	1.7	—
Effective income tax rate	166.0%	45.9%	29.4%

(1) Goodwill amortization is a non-deductible item. As the level of pre-tax income increases, the impact of nondeductible items on our effective tax rate, such as goodwill amortization, lessen.

At December 31, 2000, we had Canadian provincial net operating loss carryforwards of $94.7 million. In addition, $20.2 million of Canadian investment tax credit carryforwards and $7.8 million of United States tax credit carryforwards were available to reduce future income taxes. The Canadian noncapital loss and investment tax credit carryforwards expire at various dates between 2001 and 2010. We have United States alternative minimum tax credit carryforwards that have no expiration. We believe that deferred tax assets, net of the existing valuation allowance of $4.0 million at December 31, 2000, will be ultimately realized.

The cumulative amount of CNC's undistributed earnings through 1992, on which we have not provided income taxes, was $46.2 million as of December 31, 2000. Distribution of these earnings would qualify for the 80% dividend exclusion.

At December 31, 2000, unremitted earnings of subsidiaries outside the United States totaling $119.9 million were deemed to be permanently invested. No deferred tax liability has been recognized with regard to such earnings. It is not practicable to estimate the income tax liability that might be incurred if such earnings were remitted to the United States.

Note 17. *Dividends to Minority Interest Shareholder*

The Board of Directors of CNC declared dividends of $12.5 million in 2000 and $32.4 million in 1999. As a result, $6.1 million was paid in 2000 and $15.9 million was paid in 1999 to the minority shareholder. In 1998, the Board of Directors of CNC declared dividends of $49.6 million, resulting in payments of $24.3 million to the minority shareholder.

In January 2001, the Board of Directors of CNC declared a dividend of $9.6 million, resulting in a payment of $4.7 million to the minority shareholder.

Note 18. *Commitments and Contingencies*

Bowater is involved in various legal proceedings relating to contracts, commercial disputes, taxes, environmental issues, employment and workers' compensation claims and other matters. We periodically review the status of these proceedings with both inside and outside counsel. Our management believes that the ultimate disposition of these matters will not have a material adverse effect on our operations or our financial condition taken as a whole.

As of December 31, 2000, Bowater recorded $16.1 million for environmental liabilities. These liabilities are recorded at undiscounted amounts and are included in other long-term liabilities on the consolidated balance sheet. The $16.1 million represents management's estimate based on an assessment of relevant factors and assumptions of the ultimate settlement amounts for these liabilities. The amount of these liabilities could be affected by changes in fact or assumptions not currently known to Bowater's management. Approximately $14.0 million of the $16.1 million relates to two Canadian mills for costs primarily for soil remediation, air compliance and landfill closure.

As of December 31, 2000, Bowater has been notified that it is a "potentially responsible party" under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") of 1980, as amended, with respect to three sites in South Carolina. One site contained a small landfill on a timber tract sold to Bowater by a third party. The third party has remediated the site and continues to monitor the groundwater. Bowater has not been requested to contribute to the remediation costs. One site is a timber tract owned by CNC in which unknown third parties discarded several hundred steel drums containing small amounts of textile residue. This site has not yet been scheduled for remediation. The remaining site is a Superfund site where several parties, including Bowater, have been named as potentially responsible parties. The EPA has remediated the remaining Superfund site for a total cost of approximately $3.0 million and is currently determining how to allocate responsibility among the 120 potentially responsible parties. Bowater does not believe it will be liable for any significant amounts at these three sites.

Note 19. *Cumulative and Redeemable Preferred Stock*

Bowater is authorized to issue 10.0 million shares of Serial Preferred Stock, $1 par value. In February 1999, we redeemed all of the remaining outstanding shares for $26.6 million, including accrued dividends.

Note 20. *Stock Option Plans*

Bowater has four stock option plans — 1988, 1992, 1997 and 2000. These plans authorized the grant of up to 7.8 million shares of our common stock in the form of incentive stock options, non-qualified stock options, stock appreciation rights, performance stock and restricted stock awards. The option price for options granted under the 1988 and 1992 plans was based on the fair market value of our common stock on the date of grant, or the average fair market value of our common stock for the 20 business days immediately preceding the date of grant. The option price for options granted under the 1997 and 2000 plans was based on the fair market value of our common stock on the date of grant.

All options granted through December 31,1998, were exercisable at December 31, 2000. Options granted in 2000 and 1999 generally become exercisable over a period of two years. Unless terminated earlier in accordance with their terms, all options expire 10 years from the date of grant. The plans provide that any outstanding options will become immediately exercisable upon a change in control of Bowater. In such event, grantees of options have the right to require us to purchase such options for cash in lieu of the issuance of common stock. We received $6.8 million in 2000, $10.7 million in 1999 and $6.8 million in 1998 from the exercise of stock options. The exercise of stock options also generated tax benefits for us of $1.9 million in 2000, $4.7 million in 1999 and $2.6 million in 1998.

We record compensation expense resulting from stock option grants based on intrinsic value in accordance with APB Opinion No. 25. In accordance with SFAS No. 123, the following pro forma disclosures present the effects on income had the fair value-based method been chosen. These disclosures are shown below for 1998, 1999 and 2000 and have no impact on our reported financial position or results of operations.

	1998	1999	2000
	(In millions, Except per-share amounts)		
Net income (loss):			
As reported	$(18.5)	$78.7	$159.4
Pro forma	(22.0)	75.9	155.4
Earnings (loss) per share — basic:			
As reported	(0.44)	1.43	3.05
Pro forma	(0.51)	1.38	2.97
Earnings (loss) per share — diluted:			
As reported	(0.44)	1.41	3.02
Pro forma	$(0.51)	$1.36	$ 2.94

The pro forma net income effects of SFAS No. 123 in 2000, 1999 and 1998 may not be representative of the pro forma net income effects in future years due to changes in assumptions and the number of options granted in future years.

The fair value of each option granted was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	1998	1999	2000
Assumptions:			
Dividend yield	1.6%	2.0%	1.5%
Expected volatility	29.1%	30.0%	31.8%
Risk-free interest rate	5.6%	4.8%	6.7%
Expected option lives	5.6 years	5.6 years	5.7 years
Weighted average fair value of each option	$15.68	$12.34	$23.01

In 2000, Bowater recorded a pre-tax charge of $2.2 million for intrinsic value on its 2000 stock option grants per the provisions of Financial Accounting Standards Board Interpretation No. 44 involving stock compensation transactions recorded under the rules outlined in APB Opinion No. 25. This charge was based on a measurement date that coincided with shareholder approval of the 2000 stock option plan. An additional pre-tax charge of $2.1 million will be recorded in 2001 as these options become fully vested. The preceding table reflects the assumptions and fair market value of the options as of the measurement date. Using a measurement date based on the 2000 grant date, the weighted average fair value of each option would have been $17.51.

Information with respect to options granted under the stock option plans is as follows:

	1998		1999		2000	
	Number of Shares (000's)	Weighted Average Exercise Price	Number of Shares (000's)	Weighted Average Exercise Price	Number of Shares (000's)	Weighted Average Exercise Price
Outstanding at beginning of year	1,907	$31	2,040	$35	1,884	$37
Granted during the year	388	$49	245	$41	616	$48
Exercised during the year	(250)	$27	(387)	$28	(212)	$31
Canceled during the year	(5)	$42	(14)	$24	(3)	$23
Outstanding at end of year	2,040	$35	1,884	$37	2,285	$40
Exercisable at end of year	1,470	$30	1,455	$35	1,546	$37

	Options Outstanding at December 31, 2000			Options Exercisable at December 31, 2000	
Range of Exercise Prices	Number of Shares (000's)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Number of Shares (000's)	Weighted Average Exercise Price
$21 to $30	462	$26	3.1	462	$26
$31 to $40	291	$35	4.9	291	$35
$41 to $51	1,532	$46	7.8	793	$45
	2,285	$40	6.5	1,546	$37

Bowater has an Equity Participation Rights (EPR) Plan that allows it to grant equity participation rights to its employees. These rights confer an interest in the appreciation of Bowater's common stock price, but no right to acquire stock ownership. The rights have a vesting period of two years and, unless terminated earlier in accordance with their terms, expire 10 years after the grant date. The exercise price is the fair market value of Bowater common stock on the day of grant. The rights may be redeemed only for cash, and the amount paid to the employee at the time of exercise is the difference between the exercise price and the average high/low of Bowater's common stock on the day of exercise.

Bowater-Halla Paper Co., Ltd. (Halla), our subsidiary located in South Korea, also has an EPR plan and has issued stock options. The stock of Halla is not publicly traded. Therefore, the fair market value of the stock is determined annually by a third-party appraisal.

We record a liability for the Bowater and Halla equity participation rights and the Halla options during the vesting period and adjust this liability at each reporting period based on changes in the fair market value of the respective stocks. The liability amounts recorded at December 31, 2000 and 1999, are $18.7 million and $3.4 million, respectively. The charges (income) reflected in the Consolidated Statement of Operations pertaining to these rights and options are $16.3 million, $5.2 million, and $(2.4) million for the years 2000, 1999 and 1998, respectively.

Note 21. ***Exchangeable Shares***

In conjunction with the 1998 acquisition of Avenor, Bowater's indirect wholly owned subsidiary, Bowater Canada Inc. (BCI), issued 3,773,547 shares ($183.6 million) of no par value exchangeable shares. Since 1998, BCI has issued an additional 1,359,620 exchangeable shares ($66.2 million) upon the redemption of Avenor's 7.50% Convertible Unsecured Subordinated Debentures and 5,505 exchangeable shares ($0.3 million) for conversions prior to the redemption. The exchangeable shares are exchangeable at any time, at the option of the holder, on a one-for-one basis for shares of Bowater common stock. As of December 31, 2000, 3,834,131 exchangeable shares ($186.6 million) were exchanged for the same number of Bowater common shares. Holders of exchangeable shares have voting rights substantially equivalent to holders of Bowater common stock and are entitled to receive dividends equivalent, on a per-share basis, to dividends paid by Bowater on shares of Bowater common stock. On December 31, 2000, 1,304,541 exchangeable shares ($63.5 million) were outstanding and held by non-affiliates.

Note 22. ***Employee Stock Ownership Plan (ESOP)***

In 1989, the ESOP was funded by a $17.5 million loan. The loan proceeds were lent to an Employee Stock Ownership Trust (ESOT). The ESOP remaining loan balance of $0.7 million was paid on April 30, 2000. The ESOT has distributed all remaining shares of the original 574,160 shares of common stock to participants' accounts as of December 31, 2000.

Note 23. ***Treasury Stock***

At December 31, 2000, Bowater held 11,635,850 shares of its common stock as treasury stock to pay for employee and director benefits and to fund its Dividend Reinvestment Plan. The shares are valued at their acquisition cost of $487.0 million. As of December 31, 1999, we held 9,512,499 shares at a cost of $383.6 million.

In May 1999, the Board of Directors authorized the repurchase of up to 5.5 million shares of Bowater's common stock in the open market, subject to normal trading restrictions. Under this program, we purchased 2,125,900 shares of common stock at a cost of $103.7 million in 2000 and 1,017,069 shares of common stock at a cost of $51.8 million in 1999.

In addition, we completed a previously announced repurchase program in 1999. Under the previous program, we purchased 1,451,900 shares of common stock at a cost of $57.4 million in 1999, 2,441,100 shares of common stock at a cost of $98.1 million in 1998 and 220,000 shares of common stock at a cost of $9.6 million in 1997. We purchased a total of 4,113,000 shares of common stock, or 10% of the outstanding shares, at a cost of $165.1 million.

Note 24. ***Timberland Leases and Operating Leases***

Bowater controls timberlands under long-term leases expiring 2001 to 2058 for which aggregate lease payments were $0.7 million in 2000, $0.7 million in 1999 and $0.7 million in 1998. These lease costs are capitalized as part of timberlands and are charged against revenue at the time the timber is harvested.

In addition, we lease certain office premises, office equipment and transportation equipment under operating leases. Total rental expense for these operating leases was $5.7 million in 2000, $11.0 million in 1999 and $8.5 million in 1998.

At December 31, 2000, the future minimum rental payments under timberland leases and operating leases are:

	Timberland Lease Payments	Operating Leases, Net
	(In millions)	
2001	$ 0.7	$ 6.6
2002	0.7	5.9
2003	0.6	5.2
2004	0.6	4.7
2005	0.6	4.2
Thereafter	17.8	7.6
	$21.0	$34.2

During 2000, Bowater purchased $24.2 million of fixed assets that were previously leased. This is the primary reason that our minimum rental payments for operating leases declined in 2000 to $34.2 million from $59.3 million in 1999.

In addition, we manage over 14 million acres of Crown-owned land in Canada on which we have cutting rights. We make payments to various Canadian provinces based on the amount of timber harvested.

Note 25. *Segment Information*

Description of the types of products and services from which each reportable segment derives its revenues:

Bowater has three reportable segments: the Newsprint Division, the Coated Paper Division and the Forest Products Division. The Newsprint Division is responsible for the manufacturing operations of eight sites in the United States, Canada and South Korea. It is also responsible for the worldwide marketing of newsprint and uncoated groundwood specialties. The Coated Paper Division is responsible for one manufacturing site that produces coated groundwood paper, newsprint, market pulp and uncoated groundwood specialties and operates a coating facility, both in the United States. This Division is responsible for the worldwide marketing and sales of coated groundwood paper. The Forest Products Division operates three sawmills and manages 1.8 million acres of owned and leased timberlands in the United States and Canada, as well as 14.1 million acres of Crown-owned land in Canada on which we have cutting rights. This Division sells wood fiber to the Newsprint and Coated Paper Divisions, as well as markets and sells timber and lumber to third parties in North America. The Pulp Division has marketing and sales responsibility for all of our market pulp products; however, the financial results from these sales are included in both the Newsprint Division and the Coated Paper Division, depending upon which site manufactures the product. The Pulp Division's administrative expenses are included in "Corporate & other eliminations." Accordingly, no results are reported for this Division.

Factors management used to identify our segments:

Bowater's reportable segments are business units responsible for the marketing and sales of different products. They are managed separately because of the different products they are responsible for manufacturing and distributing.

In 2000, we revised our segment disclosures to reflect changes we made to our consolidated financial statements and to reflect how our management currently reviews our businesses. These changes included: (1) Reporting "Sales" before the deduction of distribution costs and "Special items" separately from the normal operations of the divisions; (2) reporting the elimination of intersegment sales in "Corporate & other eliminations" instead of by division, and (3) revising our asset allocations relating to the Avenor acquisition between the Newsprint and Forest Products Division and corporate. All of these changes are reflected in the tables on the following page.

The line entitled "Segment income (loss)" in the following tables is equal to "Operating income (loss)" as presented in our Consolidated Statement of Operations. In addition, none of the income or loss items following "Operating income (loss)" in our Consolidated Statement of Operations are allocated to our segments, since they are reviewed separately by Bowater's management.

The following tables summarize information about segment profit and loss and segment assets for the three years ended December 31, 2000, 1999 and 1998:

2000	Newsprint Division	Coated Paper Division	Forest Products Division	Special Items	Corporate / Other Eliminations	Total
			(In millions)			
Sales — including internal sales	$1,827.2	$586.9	$427.4	$ —	$ —	$2,841.5
Eliminations of intersegment sales	—	—	—	—	(341.2)	(341.2)
Sales	$1,827.2	$586.9	$427.4	$ —	$(341.2)	$2,500.3
Depreciation and amortization	$ 207.7	$ 58.5	$ 18.4	$ —	$ 10.6	$ 295.2
Segment income (loss)	$ 291.4	$136.1	$ 17.9	$7.3	$ (89.4)	$ 363.3
Total assets	$3,554.6	$549.0	$515.4	$ —	$ 385.1	$5,004.1
Capital expenditures	$ 147.1	$111.7	$ 23.7	$ —	$ 0.7	$ 283.2

1999	Newsprint Division	Coated Paper Division	Forest Products Division	Special Items	Corporate / Other Eliminations	Total
			(In millions)			
Sales — including internal sales	$1,672.0	$499.2	$490.0	$ —	$ 2.6	$2,663.8
Eliminations of intersegment sales	—	—	—	—	(352.1)	(352.1)
Sales	$1,672.0	$499.2	$490.0	$ —	$(349.5)	$2,311.7
Depreciation and amortization	$ 209.2	$ 55.5	$ 24.7	$ —	$ 10.8	$ 300.2
Segment income (loss)	$ 53.1	$ 72.2	$ 44.9	$133.4	$ (59.6)	$ 244.0
Total assets	$3,106.7	$492.1	$514.6	$ —	$ 438.8	$4,552.2
Capital expenditures	$ 141.1	$ 42.1	$ 13.9	$ —	$ 1.4	$ 198.5

1998	Newsprint & Directory Division	Coated Paper Division	Forest Products Division	Special Items	Corporate/ Other Eliminations	Total
			(In millions)			
Sales — including internal sales	$1,473.8	$502.5	$517.5	$ —	$ 19.2	$2,513.0
Eliminations of intersegment sales	—	—	—	—	(370.3)	(370.3)
Sales	$1,473.8	$502.5	$517.5	$ —	$(351.1)	$2,142.7
Depreciation and amortization	$ 149.4	$ 51.0	$ 23.5	$ —	$ 5.7	$ 229.6
Segment income (loss)	$ 157.5	$107.4	$ 44.1	$(98.5)	$ (48.4)	$ 162.1
Total assets	$3,441.9	$488.3	$676.2	$ —	$ 485.6	$5,092.0
Capital expenditures	$ 170.8	$ 29.6	$ 17.0	$ —	$ 5.8	$ 223.2

Special items for 2000 include gain on sale of fixed assets of $3.2 million and gain on sale of timberlands of $4.1 million. Special items for 1999 include gain on sale of timberlands of $272.5 million, loss on sale of GNP of $47.1 million and an impairment charge of $92.0 million. Special items for 1998 include gain on sale of timberlands of $21.1 million and an impairment charge of $119.6 million.

	Sales by Product		
	1998	1999	2000
		(In millions)	
Newsprint	$1,108.8	$1,282.2	$1,421.5
Coated groundwood	391.0	311.8	330.3
Market pulp	272.1	434.2	546.3
Directory paper	173.5	89.4	—
Uncoated groundwood specialties	49.3	52.1	98.1
Lumber and other wood products	148.0	142.0	104.1
	$2,142.7	$2,311.7	$2,500.3

	Sales by Country(1)		
	1998	1999	2000
		(In millions)	
United States	$1,750.6	$1,649.1	$1,711.5
Canada	28.1	170.8	197.0
Korea	44.1	102.1	134.1
Japan	44.6	39.6	42.8
Brazil	37.0	39.0	59.3
Italy	31.9	32.5	42.4
United Kingdom	22.9	38.3	52.2
Mexico	10.7	58.7	74.1
Other countries(2)	172.8	181.6	186.9
	$2,142.7	$2,311.7	$2,500.3

	Long-Lived Assets by Country 1998	1999	2000
	(In millions)		
United States	$1,773.1	$1,343.9	$1,671.1
Canada	1,412.8	1,379.8	1,431.4
Korea	195.3	182.0	187.1
	$3,381.2	$2,905.7	$3,289.6

(1) Revenues are attributed to countries based on the location of the customer. No one customer represented 10% or more of consolidated sales.

(2) No country in this group exceeded 10% of consolidated sales.

Note 26. ***Quarterly Information (Unaudited)***

	Year ended December 31, 2000				
	First	Second	Third	Fourth	Year
	(In millions, except per-share amounts)				
Sales	$562.9	$607.6	$671.8	$658.0	$2,500.3
Operating income	57.7	88.0	118.6	99.0	363.3
Net income	17.2	33.7	50.0	58.5	159.4
Basic earnings per common share	0.32	0.64	0.97	1.13	3.05
Diluted earnings per common share	$ 0.32	$ 0.63	$ 0.96	$ 1.12	$ 3.02
	Year ended December 31, 1999				
Sales	$619.8	$573.3	$555.7	$562.9	$2,311.7
Operating income (loss)	194.9(1)	27.8(2)	(52.2)(3)	73.5(4)	244.0
Net income (loss)	106.5	5.2	(53.4)	20.4	78.7
Basic earnings (loss) per common share	1.93	0.10	(0.98)	0.38	1.43
Diluted earnings (loss) per common share	$ 1.89	$ 0.10	$(0.98)	$ 0.38	$ 1.41

(1) Includes a net gain on sale of timberlands of $145.4 million

(2) Includes a net gain on sale of timberlands of $108.3 million and an impairment charge of $92.0 million

(3) Includes a pre-tax loss on sale of GNP of $55.3 million.

(4) Includes a net gain on sale of timberlands of $18.8 million and an adjustment of $8.2 million reducing the loss on sale of GNP.

SUPERIOR COURT
Commercial Division
(Sitting as a court designated pursuant to the *Companies' Creditors Arrangement Act*)

N°. 500-11-036133-094

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTRÉAL

In the matter of Plan of Compromise or Arrangement of:

ABITIBIBOWATER INC. *& al*

Petitioners

- and -
ERNST & YOUNG INC.

Monitor

- and -
AURELIUS CAPITAL MANAGEMENT, LP *& al*

Petitioner-Noteholders

BS0350 **n/dos.:** 041053-1170

EXHIBIT D-1

ORIGINAL

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