



**TimberWest**

Industry leader in second-growth harvesting

2005 Annual Report

# Timberland Management

## Continuing the Transformation

[www.timberwest.com](http://www.timberwest.com)

TSX: TWF.UN



## CONTENTS

- 3 Letters to Unitholders
- 9 Goals, Strategies & Achievements
- 31 Management's Discussion & Analysis
- 63 2005 Consolidated Financial Statements
- 89 Corporate Information

## TIMBERWEST ASSETS

TimberWest Forest Corp. is the largest owner of private forest lands in Western Canada. It runs fully contracted harvesting operations, leads the industry in second-growth harvesting and sells most of its log production on the open market, which provides considerable flexibility to meet market opportunities. The sale of logs accounts for more than 70% of the Company's revenue. The Company's private timberlands include several thousand hectares of properties that are progressively being made available for higher-value uses.

### PRIVATE LANDS

- 334,000 hectares, mostly located on Vancouver Island. The majority of sites support forests of Douglas fir, a premium species used for structural purposes.
- TimberWest applies rigorous environmental and conservation practices for wildlife and water quality protection and a wide range of other conservation goals.
- These lands support a long-term (50-year) sustainable annual harvest of 2.5 million m<sup>3</sup> of logs.

### PUBLIC LANDS

- One renewable, long-term tree farm licence and several timber licences.
- Provide the right to harvest 0.7 million m<sup>3</sup> of logs per year.

### LUMBERMILL

- TimberWest operates a lumbermill at Elk Falls capable of consuming 900,000 m<sup>3</sup> of logs annually.

### SECOND GROWTH

- TimberWest leads the industry in second-growth harvesting, with almost 70% of its logging now being done in second-growth stands.

### CERTIFICATION

- Third party auditors, KPMG Performance Registrar Inc., have certified that TimberWest, on its private forest land, conforms to the objectives and performance measures of the American Forest and Paper Association's Sustainable Forestry Initiative (SFI®).
- KPMG Performance Registrar Inc.'s third party audits have determined that all of TimberWest's operations and facilities have environmental management systems that meet the requirements and standards for ISO 14001 international certification.

Cover photo: Rory Hill, TimberWest's Manager, Production Planning.

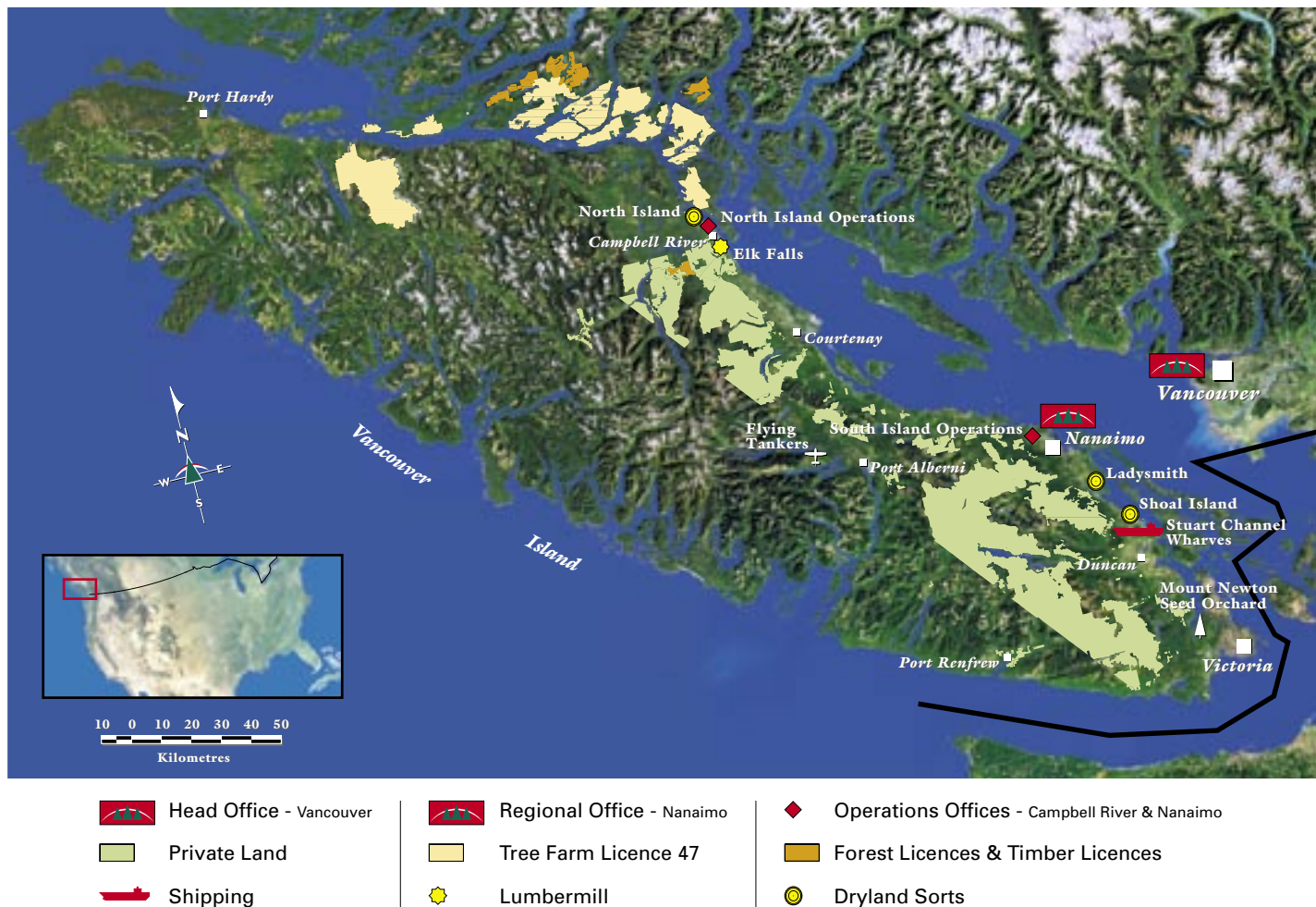
Sustained returns: This cut block, located on TimberWest's South Island Operation in the Robertson Creek area, is a perfect example of the way the Company manages timber resources for sustained returns. The area was harvested and replanted with Douglas fir in 1997. Bordering this cut block are second-growth Douglas fir stands that are ready for harvest. They will ultimately be replanted with what will become third-growth Douglas fir.

## Timberland Management: Continuing the Transformation...

The transformation of TimberWest's logging activities to a contractor model was a natural progression of the Company's Operations Excellence strategy, as it has provided increased flexibility, a reduced cost base and an operating structure more closely aligned with industry norms in the rest of North America.

The Company's future focus will be on core timberland management functions including timber inventory, strategic silviculture investments, harvest planning, and the marketing and sales of timber products and real estate.

This change is expected to improve the Company's competitiveness over the long term.





# FINANCIAL HIGHLIGHTS

	2005	2004	2003	2002	2001
<b>OPERATIONS</b> <i>(in millions of dollars)</i>					
Sales	\$ 458.2	\$ 477.0	\$ 445.4	\$ 481.1	\$ 477.8
Operating earnings	70.1	94.4	58.7	89.5	87.2
Net earnings (loss) <sup>1</sup>	4.8	23.7	(39.9)	(15.8)	4.1
EBITDA <sup>2</sup>	71.9	112.7	70.3	101.9	100.6
Earnings available for distribution <sup>2</sup> before provision for future income taxes	50.0	98.8	42.2	65.8	58.8
Distributable cash <sup>2</sup>	67.3	125.2	51.4	90.1	83.5
<b>PER COMMON SHARE AND PER STAPLED UNIT</b> <i>(in dollars)</i>					
Basic and diluted net earnings (loss) per common share <sup>1</sup>	\$ 0.06	\$ 0.31	\$ (0.52)	\$ (0.21)	\$ 0.06
Basic and diluted earnings available for distribution <sup>2</sup> before provision for future income taxes per Stapled Unit	0.65	1.29	0.55	0.88	0.90
Basic distributable cash <sup>2</sup> per Stapled Unit	0.87	1.64	0.67	1.21	1.29
Diluted distributable cash <sup>2</sup> per Stapled Unit	0.87	1.63	0.67	1.20	1.29
Distributions paid per Stapled Unit	1.08	1.08	1.08	1.08	1.08
<b>FINANCIAL POSITION</b> <i>(in millions of dollars unless otherwise indicated)</i>					
Operating working capital <sup>3</sup> (excludes short-term borrowings and distributions payable)	\$ 58.7	\$ 52.5	\$ 40.5	\$ 56.3	\$ 50.4
Total assets	1,419.1	1,434.5	1,440.9	1,478.3	1,487.2
Total debt <sup>3</sup>	232.0	217.0	255.0	236.5	378.6
Series A Subordinate Notes owned by unitholders <sup>1</sup>	695.7	690.5	684.6	684.1	580.8
Unitholders' equity <sup>1</sup>	223.7	216.6	190.9	230.7	207.7
Total capitalization <sup>3</sup>	1,151.4	1,124.1	1,130.5	1,151.3	1,167.1
Debt-to-total capitalization ratio <sup>3</sup>	20.1%	19.3%	22.6%	20.5%	32.4%
Market capitalization <sup>3</sup> (at December 31)	1,193.3	1,159.8	968.3	914.3	841.0

<sup>1</sup> Due to a change in accounting policy implemented in 2005 on a retroactive basis, prior year figures have been restated.

<sup>2</sup> EBITDA, earnings available for distribution, distributable cash, and basic and diluted earnings available for distribution, and basic and diluted distributable cash per Stapled Unit are measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles (GAAP) and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's operating performance. Reconciliations between net earnings as determined in accordance with GAAP and these measures are provided in the management's discussion and analysis included in this annual report under "Results of Operations."

<sup>3</sup> Operating working capital, total debt, total capitalization, debt-to-total capitalization ratio and market capitalization are also measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's financial resources and capital structure.

## Distributable cash

Distributable cash includes consolidated earnings before income taxes less cash income taxes, plus depreciation, depletion and amortization, plus proceeds from the sale of property, plant and equipment net of their gain (loss) on sale, less additions to property, plant and equipment and, from time to time, adjustments for other items deemed appropriate by the Company's Board of Directors.

## Stapled Units

Stapled Units are a unique form of security that combines the attributes of common shares, preferred shares and debt in a single security.

TimberWest Forest Corp. Stapled Units consist of one common share, 100 preferred shares and approximately \$8.98 face amount of Series A Subordinate Notes. These are "stapled" together as a single unit that trades on the Toronto Stock Exchange under the symbol TWF:UN.

TimberWest Unitholders receive annual interest income of approximately \$1.08 per Stapled Unit on the Subordinate Note component. Cash in excess of this amount may be distributed as declared by the Company's Board of Directors.

## FROM THE CEO

### To our unitholders:

---

2005 was another successful year for TimberWest. The Company achieved many important goals, helping to make us one of the best-performing timberland companies in North America. Our organization has been very focused on improving our cost structure and increasing our operating flexibility in an effort to remain competitive in the face of considerable revenue pressure. Overall, we think we're winning.

#### FINANCIAL RESULTS

TimberWest generated \$67.3 million of distributable cash for the year ended December 31, 2005, or \$0.87 per Stapled Unit, which is lower than our distributable cash payout of \$83.1 million or \$1.08 per unit. The year was a transitional one, with major restructuring and repositioning taking place. Financial results were affected by a number of one-time items, including the buy-back of a major log supply contract, the sale of machinery and equipment to contractors, and restructuring charges.

Even though we did not generate enough cash to cover our distributions, our financial condition remains strong, with the Company ending the year with a favourable debt-to-equity ratio of 20%. The additional borrowing that we required to cover a higher level of working

capital and the distribution shortfall was modest at \$15 million.

It was a year of record log sales volumes and exports and, while we reduced costs and improved operating flexibility, our margins came under pressure as the result of weaker sales realizations. The stronger Canadian dollar, weak domestic markets and our weaker overall species and end use sort mix were key factors in our lower realizations and distributable cash results. In addition, log prices remain depressed on the coast of BC, reflecting the poor financial condition and profitability of the converting industry. The coastal industry continued to get smaller and consolidate, with additional sawmill closures during the year (and more expected in 2006). Many of the least efficient mills took market-related downtime in 2005.

## FROM THE CEO

### AVERAGE ANNUAL INVESTMENT RETURNS

ASSET CLASS	1996-2005	1986-2005	1976-2005	1960-2005
	(10 years)	(20 years)	(30 years)	(46 years)
Timberland*	8.7%	14.1%	13.4%	12.5%
Commercial Real Estate	12.1%	8.0%	10.0%	9.7%
S&P 500	9.1%	11.9%	12.7%	10.4%
US T-Bills	3.6%	4.6%	6.1%	5.6%
US Consumer Price Index	2.5%	3.0%	4.3%	4.2%

\* Measured as the holding period returns from a portfolio of US timberland.

Source: [Hancock Timber Resource Group \(2006\)](#)

While coastal restructuring is indeed underway, it has yet to enter its revitalization stage with the injection of capital to construct new, low-cost and technologically advanced sawmills to convert second-growth timber. We believe this will come with a trade deal that provides the coast with market access, lower costs, and greater certainty over land use issues. The coast has a superb fibre base, free from the mountain pine beetle, and it is becoming a more attractive environment for investors.

Though we did not achieve targeted levels of distributable cash in 2005, lots of good work was done by TimberWest employees to better position the Company for the future, and I would like to thank everyone involved for their hard work and efforts during the year. Among the more significant accomplishments, our business model was successfully transformed with the transfer of all remaining timber harvesting and road building operations to independent contractors, we removed a major fibre supply encumbrance on the business, we once again took costs out of the system, our customer base was further diversified, and we moved a step closer to our strategic goal of becoming a “pure play” publicly traded timberland company with the announcement of a sales process for our lumbermill.

### BUSINESS TRANSFORMATION

Our business transformation program was completed in the first quarter of the year with the transfer of employees and equipment to contractors. This transition to the standard industry-wide operating model was extremely smooth. It resulted in a company with lower costs and improved flexibility while allowing remaining in-house functions to focus on strategic activities like harvest planning, silviculture, forest information systems, and marketing and sales.

### REMOVING ENCUMBRANCES

The Company invested \$15 million during the year to purchase a log supply contract it had with Western Forest Products Inc. to provide annually, in perpetuity, some 330,000 m<sup>3</sup> of sawlogs to Western’s various sawmills at prevailing domestic prices. This was a material encumbrance on the business which impaired log sales realizations. Going forward, this purchase will enhance revenues and increase flexibility in the Company’s log sales and marketing programs.

## FROM THE CEO

### COST REDUCTION

For the fourth year in a row, unit costs of production were reduced in our timberland operations. Since 2001, the Company has reduced average production costs by approximately \$14 per cubic metre, in real terms, a 26% reduction in costs. The Company also went through its third salaried employee reduction program in as many years to better align our overhead structure with the new operating model. All levels of management, including executives, were affected. While these decisions are never easy, the result is that TimberWest's competitive position has been enhanced and the remaining jobs are more secure. Our cost reduction strategy has proven to be of paramount importance in mitigating the effects of declining log realizations.

### MARKET DIVERSIFICATION

When domestic log sales volumes and prices softened early in the year, the Company's marketing and sales staff moved swiftly to place more product into the export market. The result was that export sales reached record levels in 2005. New customer relationships were established in non-Japan Asia, where TimberWest more than doubled its year-over-year sales. Large volume increases were also realized along the US west coast. Results for the year would have been markedly worse had we not taken advantage of the flexibility provided by our private lands.

When domestic log sales volumes and prices softened early in the year, the Company's marketing and sales staff moved swiftly to place more product into the export market.

For the fourth year in a row, unit costs of production were reduced in our timberland operations. Since 2001, the Company has reduced average production costs by approximately \$14 per cubic metre, in real terms, a 26% reduction in costs.

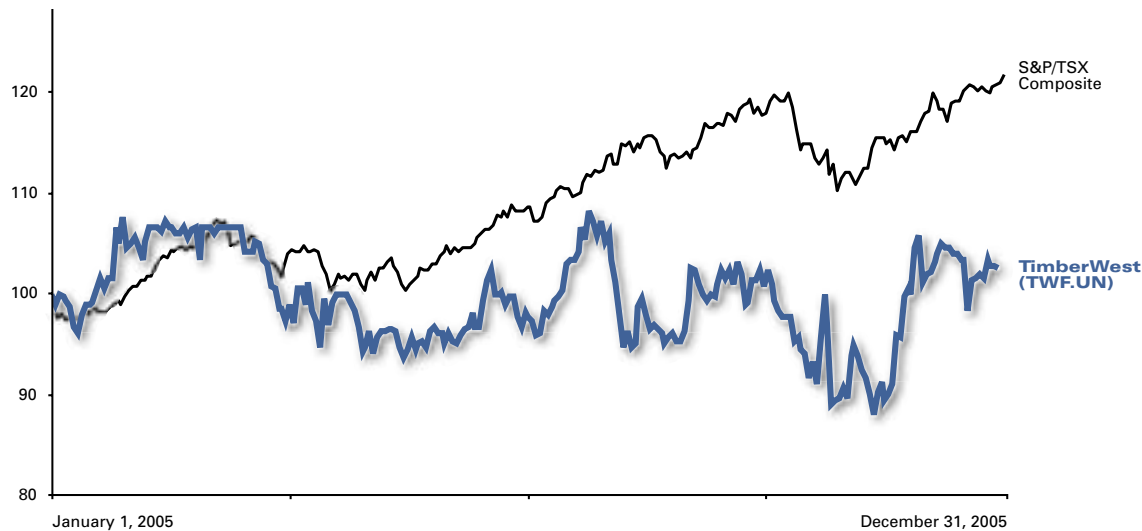
### BECOMING A PURE PLAY TIMBERLAND COMPANY

Late in the year the Company announced the start of a process to sell Elk Falls, our last remaining lumbermill. We have a strong mill management team and a talented hourly workforce at Elk Falls, and while it is one of the best performers on the BC coast, the mill requires significant new capital to become a top-quartile producer. TimberWest's core business is not manufacturing, and with our goal of becoming a pure play timberland company, we are not the logical owners for Elk Falls. Unitholders have also made their preference clear that resources and growth capital should be directed at timberlands. We are hopeful we can conclude a successful transaction in the year 2006.

Safety was an industry-wide problem in BC in the year 2005, with more than twice the number of fatalities than the previous year. At TimberWest, we have always prided ourselves on our safety focus and, while we are no longer an operating company, we continue with that focus. We are troubled by the tragic loss of life in our industry generally and about the safety of logging operations on our land base in particular. To ensure a safe work environment, the Company has set performance

## FROM THE CEO

### TIMBERWEST STAPLED UNITS VS. S&P/TSX COMPOSITE INDEX



standards, monitored operations, undertaken audits and required the development of corrective action plans by contractors when deficiencies were identified. TimberWest also actively supports the work of the BC Forest Safety Council, a multi-stakeholder organization formed recently to turn around the industry's safety record. We are particularly supportive of the council's recently announced program to safety-certify logging contractors, and we remain hopeful that marked industry-wide performance improvement will result from this initiative. TimberWest will only employ safety-certified contractors on its land base when the new certification program is operational.

The Company also remains committed to fostering sustainable forest management, maintaining water quality for domestic use and fishery values, mitigating environmental risk, and protecting key environmental values. Third party audits of our operations and our environmental management systems for compliance with our SFI® and ISO 14001 certifications were all successful in 2005.

Looking ahead, we will take advantage of a very strong real estate market on Vancouver Island to monetize more of our higher and better use properties in 2006. And we will continue actively exploring the development of new sources of revenue from our land base with exciting new initiatives such as coal bed methane gas development.

I would like to thank all TimberWest employees, contractors and suppliers for your contribution to a year of meaningful accomplishments. In particular, I would like to recognize the role of three former vice presidents who departed during the year: John Mann, Mark Stock and Virginia Aulin. Each played a major role in getting TimberWest to where it is today.

Thank you for your continued support.

Paul J. McElligott  
President & Chief Executive Officer  
February 8, 2006





BACK: Clark S. Binkley, Director; Hamish Kerr, VP Strategic Planning & Forest Policy;  
John A. Kelvin, VP Log Marketing & Sales; Gerry G. Young, VP Timberland Operations  
MIDDLE: Conrad A. Pinette, Director; V. Edward Daughney, Chairman; Robert W. Murdoch, Director; William C. Brown, Director  
FRONT: Kenneth A. Shields, Director; Paul J. McElligott, President & CEO; Beverlee F. Park, VP Finance & CFO

## FROM THE CHAIRMAN

TimberWest continuously evaluates value-added opportunities within its land base to maximize returns to unitholders.

### To our unitholders:

---

The year 2005 was a challenging one for TimberWest, and for the BC coastal forest industry as a whole. Challenges included a stronger Canadian dollar, weak domestic demand for logs and rising input costs, all negatively affecting the Company's financial results for the year. However, the Company once again enters the new year in a strong financial position.

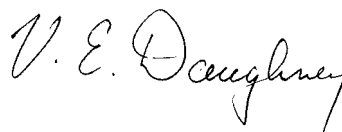
In spite of market challenges, management worked diligently to strengthen the Company internally. TimberWest achieved positive accomplishments on several fronts including business transformation, cost reduction, market diversification and the removal of a significant encumbrance on our ability to maximize sales values. In addition, TimberWest continuously evaluates value-added opportunities within its land base to maximize returns to unitholders. All of these achievements combined make TimberWest a stronger, more competitive company, better prepared for difficult years and poised for the future when external factors are more favourable for the Company.

Last year we reported on positive changes in the BC coastal forest industry. The change program on the BC coast continues, albeit slowly. There are some signs of recovery in the short term, and we expect investment, growth and a return to profitability for the coastal industry in the longer term. The past year was difficult for the industry, in particular, regarding safety. TimberWest's commitment to safety is steadfast, and we have systems and safeguards in place to ensure a safe work environment.

We are pleased that Dr. Clark S. Binkley joined our Board of Directors in 2005. Dr. Binkley brings a wealth of timberland knowledge and experience to the Board. He was formerly Managing Director and Chief Investment Officer for Hancock Timber Resource Group and the Dean of Forestry at the University of British Columbia. Dr. Binkley currently provides specialized timberland investment advisory services and sits on the boards of West Fraser Timber Co. Ltd. and Cellfor Ltd. In early 2005, Mr. Anthony J. Petrina, a founding director of TimberWest, retired from the Board, and we thank him for his eight years of dedication and contribution to the Company's success.

TimberWest's people are a key element in our achievement of success and they performed superbly in this difficult year. We are well prepared to face the opportunities and challenges ahead with our skilled workforce and a strong management team in place.

On behalf of the Board of Directors,



V. Edward Daughney  
Chairman of the Board  
February 8, 2006





## OUR GOALS, STRATEGIES & 2005 ACHIEVEMENTS

Cost reduction · Market expansion · Enhancing forest values · Safety · Stewardship

### We are a company undergoing transformation ...

In 2001, TimberWest undertook a strategic review of the Company's assets and core competencies in the context of the industry in which it operates. This review resulted in the vision of "Growing greatest value through Operations Excellence" and a focus on enhancing the performance of the Company's existing business units.

The Company implemented a number of initiatives over the past five years and has achieved considerable success in improving its cost structure and increasing its operating flexibility.

Going forward, TimberWest will continue the transition to a pure play timberland management company while also focusing on value enhancement strategies with its real estate portfolio.

Delivering value: TimberWest is focused on unlocking the value inherent in its higher and better use properties. A strategic review of the Company's land holdings, including those shown here near Shawnigan Lake, is scheduled for completion in 2006.

## COST REDUCTION

**GOAL:** To be cost competitive on a global basis.

	<b>GOAL</b> (as compared to 2004)	<b>ACTUAL</b> (2005 results)
<b>TIMBERLAND OPERATIONS</b>	<b>To reduce costs by \$1.11 per m<sup>3</sup></b>	<b>Reduced costs by \$2.28 per m<sup>3</sup></b>
<b>ELK FALLS LUMBERMILL</b>	<b>To reduce unit conversion costs</b>	<b>Reduced costs by \$300,000</b>

### PERFORMANCE OVERVIEW

#### Timberland Operations

Timberland Operations implemented its new business model in 2005, moving away from harvesting, road building and dryland sort operations with company crews to 100% use of independent contractors. The transformation aligned TimberWest with companies in most other North American jurisdictions, and allowed it to achieve additional cost reductions by decreasing investment in equipment and facilities, reducing administrative staff, and moving to competitive bids as the basis for harvesting. This resulted in the fourth consecutive year that production unit costs were reduced in timberland operations. Average production costs were reduced by \$2.28 per cubic metre compared to 2004. Further cost savings were generated through a variety of initiatives, described below.

#### Elk Falls Lumbermill

For Elk Falls Lumbermill, 2005 was a challenging year for cost reduction. The lumbermill experienced a five-week shutdown due to challenging whitewood market conditions. As well, rising oil prices negatively affected costs. However, the mill still generated efficiencies in the planermill, increasing productivity and reducing costs.

### CHALLENGES IN 2005

#### Timberland Operations

While the transition to a full contractor model went smoothly overall, the Company faced some challenges. The labour union challenged aspects of the contract structure, which was resolved by a negotiated agreement. As well, contractors challenged harvest rates due to significant fuel price increases throughout the year, which led to the adoption of a fuel cost adjustment formula for contract payments. Underlying weakness in BC's coastal harvesting business led to a high turnover for both management and labour working for coastal contractors, and a subsequent shortage of skilled labour. This necessitated an additional focus on log quality management.

#### Elk Falls Lumbermill

At Elk Falls Lumbermill, dramatically rising oil prices in 2005 resulted in surcharges for trucking, scowage and ocean-going freight, as well as increased costs on many petroleum-based supplies. The cost of producing steam to kiln-dry lumber was also negatively affected by high oil prices. The oversupply of whitewood in Japan forced 25 days of shutdown in the second quarter, negatively affecting costs. As well, aging mill machinery required higher maintenance and extra labour for cleanup.

### ONGOING STRATEGIES & 2005 ACHIEVEMENTS

#### Timberland Operations

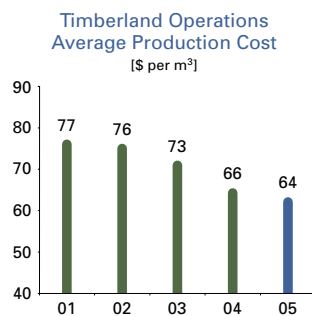
**Complete transition to full contractor model and identify new opportunities to reduce costs.**

- Increased proportion of harvesting by contractors, from 49% in 2004 to 100% in 2005. This entailed transferring 353 unionized employees to contractors and awarding contracts for long-term harvesting and dryland sort operations.



## COST REDUCTION

- Sold 393 pieces of production and transportation equipment to long-term contractors working with TimberWest. The Company sold an additional 135 pieces of equipment and all remaining inventories of equipment parts and operating supplies.
- Consolidated all timberland operations administrative and contract management functions into two office sites on Vancouver Island, and sold, leased or closed four offices and equipment maintenance shops.
- Reduced administrative staff by nine positions following conversion to the contractor model.



### Elk Falls Lumbermill

**Continue to reduce WorkSafe BC premiums through improved safety performance.**

- At Elk Falls Lumbermill, improved safety performance led to a reduction in WorkSafe BC premiums of 36.6% compared to base rates, saving the Company approximately \$180,000.

**At Elk Falls Lumbermill, continue to lower conversion costs.**

- Improved efficiencies in the planer mill to alleviate the potential requirement for operating a third shift. This resulted in a 10% productivity increase and a savings of \$330,000.

## 2006 TARGETS

### Timberland Operations

Rate negotiations with long-term harvesting contractors for 2006 are showing upward pressure due to a Coast Master Agreement wage rate increase and higher prices for lubricants, explosives and other supplies. The Company mitigated these pressures and will continue to do so by challenging contractors to improve productivity and use the most cost-effective harvesting systems.

TimberWest will continue to expand its list of qualified short-term, competitive-bid contractors for harvesting and increase exposure to potential bidders for future long-term contracts. Since TimberWest no longer employs company crews for harvesting, it will work to change its WorkSafe BC rate classification to one more appropriate for timberland management.

In 2006, TimberWest will also investigate high-technology fleet management to maximize log truck dispatching and manage logging truck driver efficiencies. It will maximize scaling under artificial light to extend the hours sort facilities can be used and move to an allowance-based vehicle program to eliminate the need for most company-owned vehicles.

### Elk Falls Lumbermill

Elk Falls Lumbermill will continue to tap into its strong mill management and talented hourly workforce to become a low-cost producer by improving lumber processing, doing preventative maintenance and enhancing lumber recoveries. As the existing collective agreement expires May 1, 2006, the greatest challenge in the coming year will be to secure a collective agreement that ensures the lumbermill will remain globally competitive in the future.

## COST REDUCTION

→ Open communication: TimberWest South Island Contract Manager John Shearing (left) and Kent Horsley, Ladysmith/Shoal Island Dryland Sort Supervisor for Ted LeRoy Trucking Ltd. (right) combine their respective knowledge and experience to realize efficiencies and manage costs.

### BEST PRACTICES: Tapping new technology for optimal timberland management

As TimberWest moves to become a timberland management company, its focus has changed from managing people to effectively managing the land base. This means using the right technology to better manage information.

“Gone is the focus on core accounting systems such as payroll and accounts payable that we needed when we had large company-owned operations,” says Timberlands Operations Controller Bob Blanchard. “We are now able to focus more attention on systems that help us make the best decisions relative to managing the land base.”

The Company has already implemented powerful new forest inventory modelling software to better project long-term sustainable harvest rates, as well as a sophisticated planning model called Winfall.

“This new capability allows us to do nearer term assessments of future costs and values on a setting-by-setting basis, allowing us to intelligently adapt to changing conditions,” says Manager of Production Planning Rory Hill.

Other sophisticated new software helps TimberWest’s contract managers identify optimum logging solutions and costs as a basis for negotiating harvest rates with contractors.

The Company is also working to replace its log inventory control system (LINC) by mid-2006 with the next generation of software.

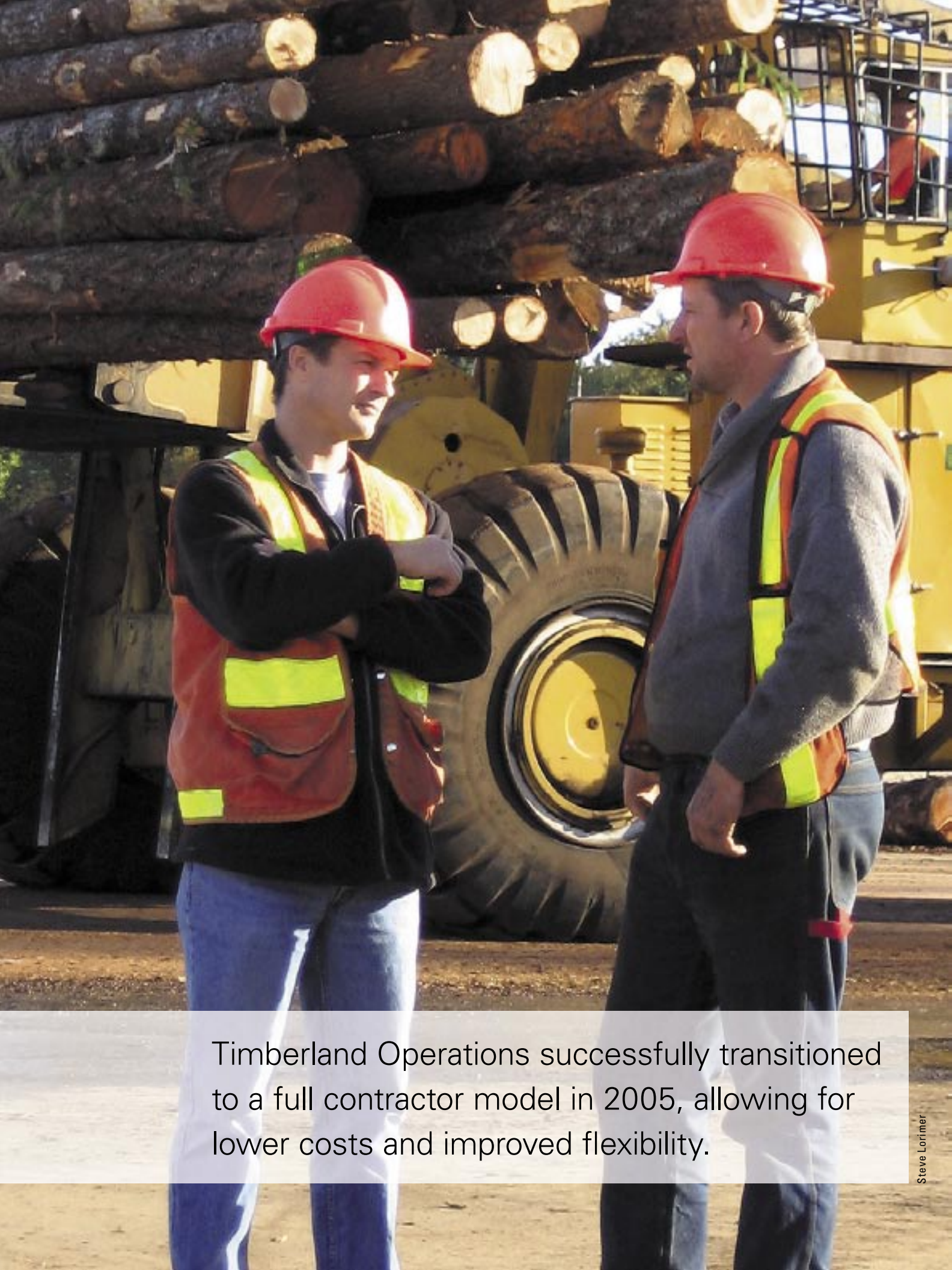
“Our new system, called LIMS, will not only replicate our real-time knowledge of log inventory and location, but will tie in to our customer invoicing and contractor payment processes,” says IT Director Kelly Gilchrist.

Rounding out these moves to improve land and process management systems, TimberWest is assessing upgrades to its Forest Information and Geographic Information System that identifies and maps forest and other land values. This upgrade is expected to be completed by 2007.

Multiplier effect: Advanced technologies provide information that ensures the best decisions are made in managing TimberWest’s land base.







Timberland Operations successfully transitioned to a full contractor model in 2005, allowing for lower costs and improved flexibility.

## MARKET EXPANSION

**GOAL:** To diversify markets and maximize the return on all logs and lumber produced.

### PERFORMANCE OVERVIEW

#### Log sales

Overall, log sales volumes in 2005 were 11% higher than in 2004, with sales volumes in BC, the Company's largest market, decreasing by 6% while export sales increased by 43%. Domestic log sales, totalling 1.96 million m<sup>3</sup>, were lower due to adverse market conditions experienced by coastal BC log converters.

Sales were higher in all export markets, including the US, Japan and other Asian markets, notably Korea, compared to 2004 levels. TimberWest sold 1.65 million m<sup>3</sup> of logs into these markets in 2005, a record for the Company, eclipsing the previous high of 1.38 million m<sup>3</sup> in 2002. New customers were developed in virtually every export market.

#### Lumber sales

Elk Falls Lumbermill continued its focus in 2005 on matching timber supply to products and markets. During the year, new product lines were developed to complement existing programs where feasible, and new programs were introduced as market demands dictated. Despite persistently high inventory levels in Japan throughout 2005, the Lumbermill was able to improve its market share in Japan by competing effectively against other suppliers.

In Europe, supply-and-demand dynamics of the market were upset by the arrival of a new supplier. As a result, the Company's supply into this market was limited in 2005, but is expected to resume in 2006. TimberWest's participation in seven distinct lumber markets on four continents provides the flexibility needed to best manage log supply for market returns.

### CHALLENGES IN 2005

#### Log sales

The biggest challenge for TimberWest in 2005 was to react quickly to changing dynamics in weakening BC

markets by increasing the Company's international log marketing programs in all export market areas. The efforts of the log marketing team enabled the Company to harvest planned volumes and at the same time reduce the watered log inventory by over 125,000 m<sup>3</sup>.

#### Lumber sales

International currency exchange rates continued to present a challenging business environment for TimberWest's lumber sales. In addition, higher fuel costs negatively affected all transportation and services throughout the distribution chain. The introduction of invasive species and pest management standards for all packaging material used to export products into China, Taiwan, Hong Kong, Korea and Mexico presented new challenges that are expected to continue into 2006 as other countries sign on to this initiative.

### ONGOING STRATEGIES & 2005 ACHIEVEMENTS

#### Log sales

**Find new markets and opportunities for maximizing log value.**

- Repositioned the Company's products by increasing export sales to all export markets, with the greatest increases to US and non-Japan Asian markets. This strategy was necessitated to offset the effects of continued weakness and structural changes in the coastal BC forest industry, including mill closures and the sale of companies.
- The decision to increase the harvest of low-margin stands resulted in increased volumes of lower quality hemlock logs, which were better suited to emerging Asian markets, in particular Korea and China.
- Ensured that the logs produced from the increased harvest of low-margin stands were manufactured and marketed to maximize returns. Programs were introduced that doubled volumes to these emerging Asian markets in 2005.



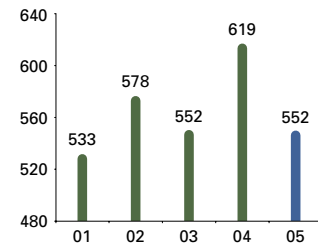
## MARKET EXPANSION

### Lumber sales

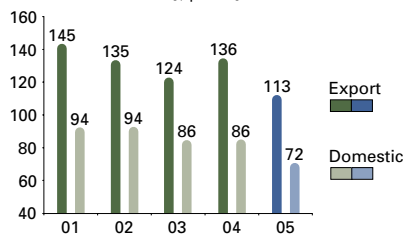
Expand sales of value-added products.

- Focused on the development of products and markets that best match log supply to product valuations.
- Successfully developed Hemlock Lamina to be used in the production of engineered structural products. Further developed Douglas fir programs, expanding product lines for broader access to markets.
- Continued focus on kiln-dried, value-added products where higher mill realizations could be attained.

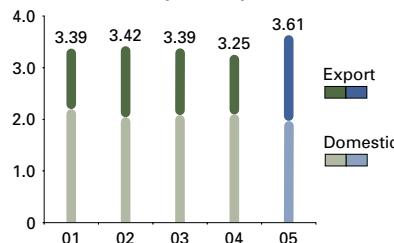
Average Lumber Sales Realizations  
(\$ per mfbm)



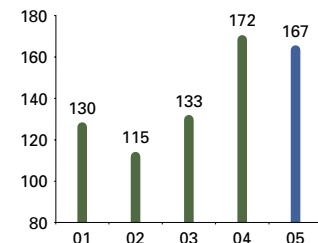
Average Log Sales Realizations  
(\$ per m³)



Log Shipments  
Export & Domestic Markets  
(million m³)



Lumber Shipments  
(mmfbm)



### 2006 TARGETS

#### Log sales

As the coastal BC forest industry continues to restructure in 2006 with the consolidation of the Crown timber harvest and the manufacturing base, weak domestic markets are expected to prevail. To counter this and ensure the highest return on every log harvested, TimberWest will maintain its efforts to increase log sales in international markets. The Company's purchase of its long-term log supply agreement with Western Forest Products in the third quarter of 2005 has made available 330,000 m³ of logs, which will comprise the basis for increased log exports in 2006. Efforts will be made to improve transportation logistics to reduce the overall cost of servicing the international marketplace.

#### Lumber sales

Continued diversification and adaptability will be the hallmarks of Elk Falls Lumbermill's sales program in 2006 as it responds to changing conditions and market requirements in both products and specifications. The lumbermill will develop and maintain product lines that are competitive with other jurisdictions, and continue to move product lines up the value chain. As well, the mill will continue to adapt products to meet possible import restrictions in various jurisdictions regarding pests and pathogens in green lumber exports.

## MARKET EXPANSION

→ Being selective: Careful pre-selection and harvesting of cedar poles in advance of the type of highly productive, mechanized harvesting shown here maximizes pole volumes recovered and value received for TimberWest's forest resources.

### BEST PRACTICES: Cedar poles: Making the most of a good thing at Johnstone Strait

In today's demanding wood products marketplace, two factors add up to success: keeping costs down while getting the highest value from every tree harvested.

At TimberWest's Johnstone Strait Operation, the Company's Log Marketing and Sales Group worked closely with production personnel to accomplish just that by pre-harvesting tall, straight cedar trees to fulfill a niche market for high-value power poles.

"In 2004, we realized that domestic cedar markets were weakening, largely because consumers were moving to substitute products," says Area Engineer Peter Share. "It only seemed logical that with a declining cedar market we should get creative with the products we could produce, and cedar poles were a clear winner for us."

Under the direction of Doug Tomlinson, Contract Manager for Johnstone Strait, the cedar poles were identified then selectively harvested by specialized contractors prior to the mechanized harvesting of the remaining stand. This maximizes the volume and quality of the poles without interfering with mechanized techniques.

Cedar poles are valued from \$180 to \$250/m<sup>3</sup> depending on size and quality. The Johnstone Strait program yielded approximately 5,500 m<sup>3</sup> of cedar poles at an average value of \$210/m<sup>3</sup>, or about 200% more than what would have been otherwise realized, even though a more costly, less productive process is involved.

"The success of this type of program depends largely on our ability to work together, communicate well and be on top of market trends," says Tomlinson. He adds that the experience has motivated him and Share to watch for further opportunities aimed at similar high-value niche markets.

With strong demand for cedar poles expected to continue due to the rebuilding effort in the wake of Hurricane Katrina, TimberWest will be promoting the extraction of cedar poles throughout its operations. This effectively complements the Company's fir pole program.



Rory Hill

Market niche: Specialized markets for cedar poles proved to be a winner for TimberWest's Johnstone Strait Operation in 2005.



TimberWest's greatest challenge in 2005 was reacting quickly to changing dynamics in weakening BC markets, and offsetting the effects with increased international log marketing programs.





## ENHANCING FOREST VALUES

**GOAL:** To increase the value of the operable private timberland base.

### PERFORMANCE OVERVIEW

TimberWest's long-term commitment to enhancing forest values paid extra dividends in 2005, partially offsetting the effect of a rising Canadian dollar and reinforcing the Company's strategy to become a leader in timberland management. Mount Newton Seed Orchard demonstrated continual improvement through improved pest control and by planting better seed-producing trees that will increase yields by up to 19%. As well, improved planting schedules coupled with wetter, cooler weather resulted in higher survival and growth rates for seedlings. The Company's enhanced land base classification program is on target, setting the stage for major software upgrades in 2006 to improve forest modelling capabilities.

#### Real estate

The real estate sales program for TimberWest's higher and better use properties took advantage of the stronger real estate markets on Vancouver Island by placing an additional \$20 million worth of property on the market. The Company also marketed the former Youbou mill site and adjacent development lands, as well as surplus operations facilities made redundant through contracting out timberland operations.

### CHALLENGES IN 2005

Some mortality and poor performance of seedlings slated for the 2006 reforestation program occurred at some of TimberWest's contract nurseries. However, the Company was able to source replacement seedlings. Since any nursery can have a catastrophic event at any time, three new contract nurseries will be brought online in 2006 to mitigate future risk of poor performance at specific nurseries.

Increased petroleum costs translated into increased costs for many products and services, including seedling production, fertilizer, and aviation fuel for the Flying Tankers Inc. Martin Mars aircraft and for helicopters used in late-rotation fertilization.

### ONGOING STRATEGIES & 2005 ACHIEVEMENTS

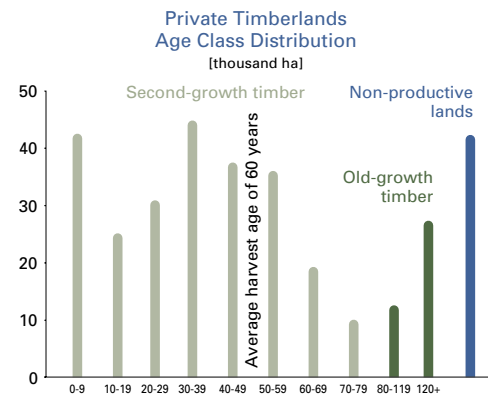
#### Increase the growth rate of the forest.

- Planted approximately 4.7 million seedlings. Most of these trees originate from improved seed produced at the Company's Mount Newton Seed Orchard. TimberWest's improved seed from the most valuable species, Douglas fir, averages a performance gain of 11% over unimproved seed.
- Improved planting schedules resulted in significantly higher initial survival and growth rates when coupled with the increased levels of precipitation during late spring and summer.
- Upgraded Mount Newton Seed Orchard. Three hectares of this 40-hectare facility were rehabilitated to make room for the next generation of trees. This project will result in improved performance gain from seed produced by trees in the rehabilitated area from the previous level of 4% to 19% within 7 to 10 years.
- Improved seed yield and forest health through enhanced insect control. Crews collected 330 hectolitres of high-value cones that were protected from damage that affected other orchards in the area. New monitoring systems and control practices reduced damage to TimberWest's orchard trees by insects, disease, drought and other agents by approximately 30% over previous years. The superior seed from these cones is expected to produce approximately 4.5 million Douglas fir, 1.5 million western red cedar and 1.5 million western hemlock seedlings.
- Continued multi-year, late-rotation fertilization program. Successfully fertilized more than 3,443 hectares of TimberWest's private timberlands, which will lead to enhanced timber yields and improved log values. TimberWest has used a late-rotation fertilization program for over 35 years. Over 15,000 hectares have been treated in the past six years alone.

## ENHANCING FOREST VALUES

### Classify land base and improve access to information.

- Cruised 15% of second-growth timber in the third year of the Company's four-year inventory plan. So far, 45% of second-growth timber has been cruised. By the end of the fourth year, 60% will have been cruised, a ratio that will be maintained.
- Continued to improve the Company's forest modeling capabilities through enhanced information gathering and better software systems. This allows TimberWest to better project future timber growth rates and harvest schedules.



### Real estate

#### Maximize value through higher-use property opportunities.

- Evaluated and listed an additional \$20 million of higher and better use properties to take advantage of stronger real estate markets on Vancouver Island. National real estate firms are marketing these potential development lands, located near fast-growing communities. Several unique wilderness properties with resort potential located near Port Renfrew and Nitinat were also listed for sale, attracting considerable interest.
- Marketed the former Youbou mill site and adjacent lakefront development lands through a competitive bidding process. After receiving a strong response, an agreement was reached, with the sales transaction anticipated to close in 2006.
- Sold the Company's operating facilities at Honeymoon Bay and its shop and office properties at Courtenay. These facilities became surplus when the Company moved to full contractor operations.

### 2006 TARGETS

TimberWest will continue to manage costs and improve the value of its timberlands by continuing late-rotation fertilization, minimizing seed losses from pests and disease, and upgrading its seed orchard to realize an increase in average performance gain from the current level of 10% to 19% over the next 10 years. The Company will also investigate using newly developed software to upgrade forest information systems. This new technology will enhance TimberWest's ability to manage forest inventory and meet increasingly exacting certification and regulatory standards.

### Real estate

As well, the real estate sales program will continue to capitalize on strong real estate markets for all Vancouver Island locations. A strategic review of the Company's entire land holdings is underway and will be completed in 2006.

## ENHANCING FOREST VALUES

→ Spectacular value: Significant opportunity exists for TimberWest's portfolio of unique real estate properties that can be put to higher use in the rural recreational and resort markets. This includes outstanding properties located on the shores of Kissinger Lake, shown in the foreground, and Cowichan Lake, shown beyond.

### BEST PRACTICES: Exceptional value in exceptional properties

TimberWest owns some spectacular real estate on Vancouver Island — property that rivals the beauty and value of prime real estate in countless locations around the world yet remains reasonably priced by global standards.

The impressive real estate markets now playing out on Vancouver Island mean that TimberWest's real estate holdings are well placed to take full advantage of them.

Recently, all segments of the market have seen significant increases in value, particularly residential housing values, which have soared 22% during 2005. And the trend is expected to continue due to numerous factors, including housing and land affordability, retirement migration and the quest for a quieter lifestyle in a temperate climate close to amenities such as health care and transportation.

"Vancouver Island offers all of these attributes, so it's attracting strong interest from local, national and international

developers searching for large, quality development properties," says TimberWest's Director of Real Estate, Gordon Littlejohn.

"Given this level of interest, exceptional opportunities exist for TimberWest's outstanding mountain and lake-view properties that can be put to higher use, especially those in the residential, rural recreational and resort markets."

The Company holds an extensive portfolio of residential and rural development lands in and around the fast-growing communities of Campbell River, Courtenay, Sooke and Duncan. It also owns a number of unique lakefront, riverfront and resort-type lands at Caycuse on Cowichan Lake and in the Port Renfrew and Nitinat areas west of Victoria.

A strategic review of TimberWest's land holdings currently underway is scheduled for completion in 2006. The main objective: to ensure that values are being optimized and lands are being put to their highest and best economic use, be that for commercial forestry or real estate purposes.

"We expect that a significant number of real estate properties will be added to TimberWest's current portfolio of higher and better use lands," says Littlejohn. "The portfolio that emerges will be segmented by project type and the potential for value-added activities, such as zoning and dividing land into parcels, keeping in mind the optimal timing in bringing properties to market. Our goal is to create and capture maximum value from these properties."

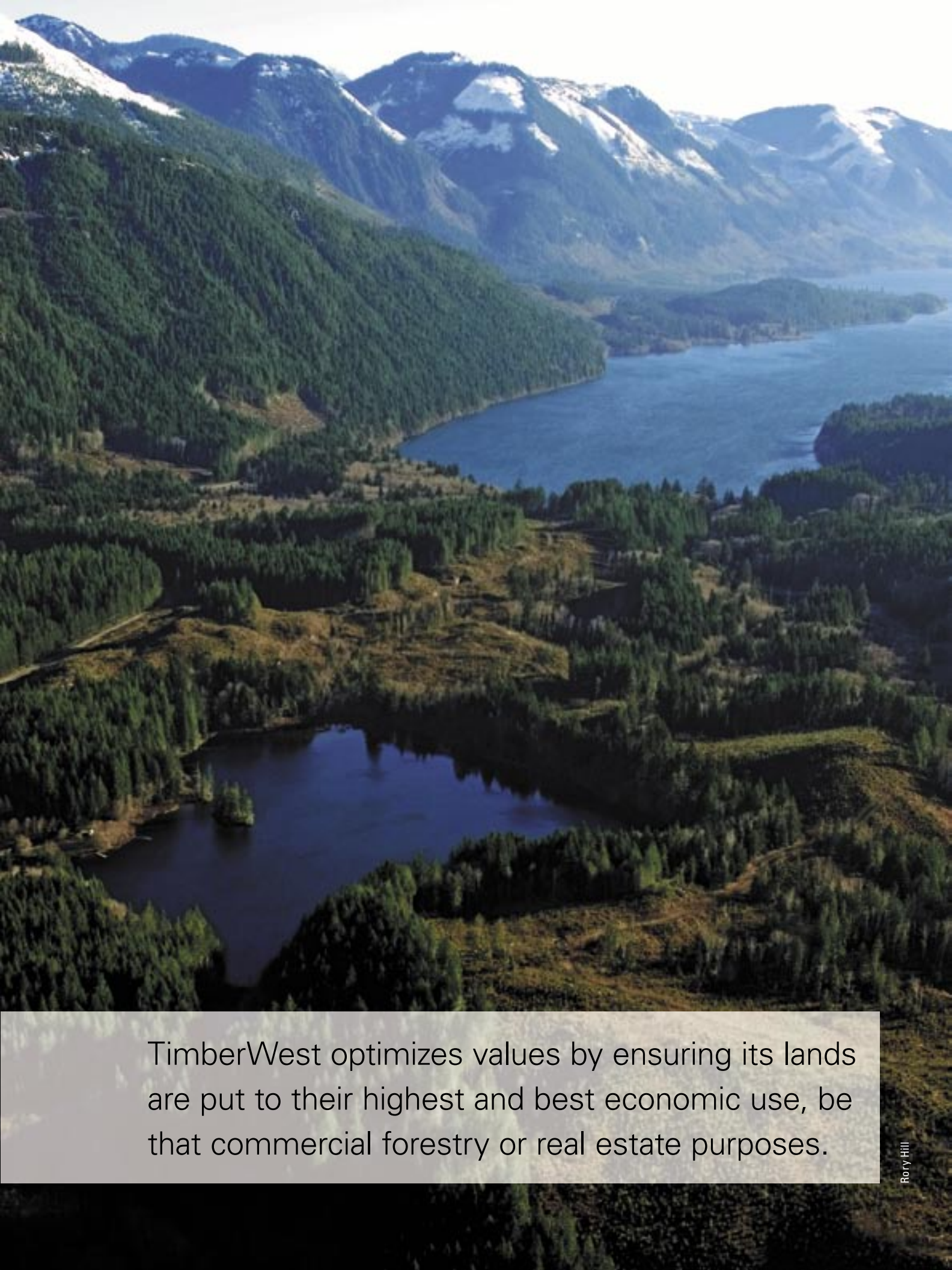
With a larger portfolio of properties and a refined focus on capturing the value inherent in these assets, real estate will play a greater role in the future in delivering value to TimberWest's unitholders.



Rory Hill

Superior returns: Reproducing Douglas fir trees with superior characteristics by grafting them improves yields when the trees are harvested in 40 to 50 years.





TimberWest optimizes values by ensuring its lands are put to their highest and best economic use, be that commercial forestry or real estate purposes.

## SAFETY

# GOAL: To achieve the best safety record in coastal BC for both logging and sawmilling.

### PERFORMANCE OVERVIEW

#### Timberland Operations

Two fatalities affected safety performance in 2005. As a result, the 2005 Medical Incident Rate (MIR) for Timberland Operations was 7.68, compared to 5.57 for 2004.

The Company was deeply concerned that two people were killed on the job, one at Shoal Island Dryland Sort, the other at a heli-logging site. Any fatality or injury is unacceptable. Improving safety performance is a priority, which is being carried out through initiatives described below.

Ensuring that TimberWest is working with qualified companies that meet its safety requirements is the foundation of the Company's contractor safety management system. This entails monitoring contractor performance standards, conducting audits and taking corrective action as required. Overall, TimberWest was pleased with audit results, especially for its single-stem helicopter logging contractor.

#### Elk Falls Lumbermill

Safety was the one area where the lumbermill did not meet its 2005 goals as well. The 2005 MIR was 3.94, compared to a target MIR of 2.50. Despite not meeting its targeted MIR, results were better than the sector average of 6.14. Because of its higher exposure hours in 2004, Elk Falls was bumped up to the "over 500,000 hours" category. The lumbermill ranked fourth in safety performance out of 12 coastal BC companies in its category reporting to the Forest Industry Advisory Service.

While the 2005 MIR was above target, the lumbermill continued to do a good job in claims management. For 2005, it once again secured a 36.6% discount from WorkSafe BC base rates, saving the Company approximately \$180,000 in premiums.

### CHALLENGES IN 2005

#### Timberland Operations

A major challenge for Timberland Operations was to implement TimberWest's contractor safety policy and to monitor contractors to ensure they had effective safety programs and complied with safe work procedures.

#### Elk Falls Lumbermill

Managing repetitive stress injuries at the Elk Falls Lumbermill was a significant challenge in 2005. As new employees settled into unfamiliar job duties and production flows stabilized, repetitive stress injuries challenged the entire safety program. Injury management initiatives developed and implemented during 2005 are showing results and will continue to be a main focus at Elk Falls.

Another area that challenged the safety standard at the lumbermill was new employee compliance to safety policies and procedures. Focused efforts were made throughout the year to change this situation and have resulted in a significant reduction in safety infractions.

### ONGOING STRATEGIES & 2005 ACHIEVEMENTS

#### Timberland Operations

**Review and assess contractor safety programs to ensure they meet TimberWest's and other criteria.**

- Initiated an independent review of the Company's contractor safety management system.
- Conducted basic safety program assessments on all short-term contractors to determine if they meet TimberWest's and external regulatory requirements. Action plans were developed by contractors to address shortcomings identified and were monitored for effective implementation.
- Conducted comprehensive safety program audits on all long-term contractors and a portion of the Company's short-term contractors. Independent audits were conducted by a qualified external

## SAFETY

agency as required. With the assistance of safety auditors, contractors developed action plans for deficiencies identified. These plans were monitored to ensure corrective procedures were implemented.

- Supported initiatives implemented by the BC Forest Safety Council, including the development of a new contractor safety certification program.

### Elk Falls Lumbermill

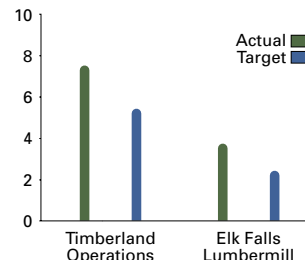
**Increase training for safety representatives and improve incident prevention procedures.**

- Maintained training hours for safety representatives at the same level as 2004.
- Trained employees in hatch watch protection and confined space work procedures.
- Continued training initiatives in critical areas such as mobile equipment and rigging and slinging.

**Continue to meet or better increasingly higher safety standards and minimize accidents through proactive safety measures.**

- Intervened at an earlier stage with employees exhibiting high-risk behaviour and a lack of attention to safety standards. This initiative is showing significant payback in lower injury trends with younger workers hired during the 2003–04 expansion.
- Developed an updated Incident Command protocol to respond to any accidents, close calls or other critical incidents.
- Increased vigilance and awareness of the importance of wearing of high-visibility apparel and personal protective equipment. Increased compliance levels were achieved, however, a sustained focus must be maintained to keep the current standard.
- Advanced injury management training for first aid attendants contributed to lower medical aid levels. Reducing the need for employee hospital visits reduces the risk of time-loss injuries.
- Installed a monorail to assist in saw changes and lifting at one of the secondary breakdown machine centres. This significantly reduced the potential for serious back injuries in an area identified by the Safety Committee as having the highest potential for this type of injury.

2005 MIR Comparisons



**Medical Incident Rate (MIR)** is the number of recordable cases per 100 full-time-equivalent employees per year. It is calculated by multiplying the number of cases by 200,000 and then dividing by the exposure hours worked by all employees.

## 2006 TARGETS

### Timberland Operations

TimberWest has always taken workplace safety very seriously and will continue to do so. In 2006 in Timberland Operations, the Company will improve on the execution of its contractor safety management program and will complete the application of its safety audit program to all contractors. In addition, once the BC Forest Safety Council completes its new safety certification program, the Company will only employ safety-certified contractors on its land base.

### Elk Falls Lumbermill

With its ongoing objective to be the safest sawmill in coastal BC, Elk Falls Lumbermill has set a 2006 MIR target of 2.5 and aims to reduce the overall severity of incidents by 25%. This will be achieved by strategies such as certifying a maintenance staff member to train fellow workers in the safe operation of elevated work platforms and a continued emphasis on the proper use of fall protection. TimberWest will continue to take appropriate steps to ensure employee compliance with safe work procedures and the use of personal protective equipment. Attention to program details and follow-up of at-risk behaviour will be paramount.



# SAFETY

→ Staying on top: Boom Utility Worker Mike Manson, shown here at TimberWest's Elk Falls Lumbermill, takes safety seriously. His secret: staying agile and applying 24 years of experience in assessing risk.

## BEST PRACTICES: Working safe at high-risk jobs

While dozens of employees have excellent safety records at Elk Falls Lumbermill, many would say that two with outstanding records — Peter Dobinson and Stig Eriksson — also have the riskiest jobs of all.

Dobinson has worked at just about every position on the sawline over the past 19 years, which qualifies him perfectly for his job as a floater. That means keeping the flow of the wood through the mill running smoothly and helping whenever there's a breakdown, doing things like cutting logs out of large bandsaws with a chainsaw.

Although he admits the responsibility to get things rolling again can be stressful, he says modern mills with good safety programs like Elk Falls are much safer than mills once were.

"Other mills I worked at years ago never even had a safety program or lockout," says Dobinson. "That doesn't mean that mills today aren't dangerous. But if you stop, think things through, lock it out and do it properly, it shouldn't be a problem.

"It all comes down to knowledge and experience."

Those are principles Millwright Stig Eriksson also draws on to stay safe. Known for his professional, meticulous work habits and respectful attitude, Eriksson has been lost-time-incident-free for 44 years, despite working in tight spots and moving huge components that may weigh 100 pounds or more.

"You have to work smart," says Eriksson, "whether it's avoiding accidents that can happen in a flash, or preventing wear and tear on your body over time.

"It all goes back to the things I learned in trade school in Sweden — how to lift or move things the right way, how to keep out of the way to avoid being hurt. I also look out for the other guys, especially the new ones, and always try to show them what I've learned."

Working smart: Between them, Elk Falls Lumbermill employees Floater Peter Dobinson (left) and Millwright Stig Eriksson (right) have logged over 60 years at work without a single lost-time incident.



Boomer Jerritt



TimberWest's commitment to safety is steadfast. Focusing on fundamental safety principles is key: stop; think things through; lock it out; do it properly.



## STEWARDSHIP

**GOAL:** To foster the Company's social licence to operate.

### PERFORMANCE OVERVIEW

Even as the Company's timberland operations have been contracted out, TimberWest remains committed to fostering sustainable forest management, managing environmental risk and protecting key environmental values. The transition to the full contractor model meant some new challenges, including playing a heightened supervisory role with contracted companies to ensure TimberWest's stewardship standards were met and adapting environmental management systems to fit the new model.

TimberWest demonstrated its ongoing commitment to good stewardship by complying with all environmental regulations, conforming to two international certification systems, and participating in partnerships with conservation and community organizations.

### CHALLENGES IN 2005

Meeting certification standards was a particularly significant achievement because of major changes that took place over the past year. TimberWest's environmental management systems had to be adapted to address the transition to a full contractor model for timberland operations, and to address changes in standards for both SFI® and ISO 14001.

Maintaining the confidence of government regulatory agencies so that TimberWest's regulatory burden is not increased is an ongoing challenge, one that the Company again met in 2005 through its good stewardship.

### ONGOING STRATEGIES & 2005 ACHIEVEMENTS

**Maintain or enhance certification under Sustainable Forestry Initiative (SFI®) and ISO 14001 programs.**

- Completed annual third party environmental audits by KPMG Performance Registrar Inc. Maintained registration under two international certifications, SFI® and ISO 14001, under the full contractor model.

**Ensure full environmental regulatory compliance and strive for excellence in stewardship.**

- As in previous years, fully complied with environmental regulations. This was the first full operating

year of the provincial government's Private Managed Forest Land Act and its innovative administrative model, the Private Managed Forest Land Council. TimberWest's Oyster River Operation was one of the sites chosen at random by the council for independent audit to determine compliance and the program's effectiveness in meeting its objectives. The audit indicated excellent results in all areas.

- Maintained excellence in watershed management by meeting with community watershed committees, local watershed user groups and water licensees to review harvest plans and other watershed initiatives that could affect water quality within domestic water supply areas. Completed water quality sampling and analysis for domestic water use and fisheries values within sensitive watersheds on TimberWest's private lands.
- Received the Forest Stewardship award from [Wildlife Habitat Canada](#) for the Company's contributions to the protection of salmon habitat on the Englishman River.
- Conducted summer-long surveys of marbled murrelets and Queen Charlotte goshawks, two red-listed species and keystone indicators that TimberWest monitors in ongoing programs to determine the overall health of the forest.

**Preserve high standards of loss control.**

- Extinguished 13 small fires on company timberlands on the day of discovery, 10 of which were started by recreational or other users. TimberWest's subsidiary, [Flying Tankers Inc.](#), maintained ongoing surveillance and took action on five fires on company timberlands in 2005. The Martin Mars aircraft played a diminished role in forest fire fighting this year due to cooler, wetter weather in western North America. Systems to provide a fire suppressant, Thermogel, were installed on one Mars bomber, which will make the aircraft more versatile for firefighting applications.
- Continued efforts to maintain and enhance the growth of newly regenerated forests, including aggressive vegetation management to eliminate plants that compete with crop trees.



## STEWARDSHIP

- Contracted various local First Nations groups for initial attack on forest fires and/or vegetation control.

### Work with partners to enhance the environment.

- Made significant progress increasing Vancouver Island marmot populations, with a record 48 marmot pups born in captivity. In 2004, 9 marmots were released into the wild; in 2005, 15 were released, with 20–25 marmots slated for release in 2006. TimberWest is the largest financial contributor to this initiative, and is active on the [Marmot Recovery Board](#) and the Marmot Recovery Team.
- Continued partnership with the [Pacific Salmon Foundation](#) along with annual financial commitment of \$60,000 to provide streamkeepers groups associated with TimberWest's private lands with funding to carry out fish habitat stewardship programs.
- Worked with the [Nature Trust of British Columbia](#) to protect, by way of restrictive covenant, 1.3 kilometres of stream bank along the Englishman River. This complements stream protection provided by the adjacent Englishman River Regional Park, which was partially formed from land donated by TimberWest.
- Continued the agreement with the [Nature Conservancy of Canada](#) to research areas of rare ecosystems and critical wildlife habitat on company timberlands.
- Continued agreement with the [Forest Research Extension partnership \(FORREX\)](#) to enhance sustainable and adaptive management in BC's forests.
- Maintained good working relationship with [Ducks Unlimited](#) through ongoing initiatives.

### Support organizations and projects that improve the stewardship of resources in communities where TimberWest operates.

- Provided financial support for a summer student at the [North Island Wildlife Recovery Association](#) and funding to the [Mountaineer Avian Rescue Society](#).
- Supported the activities of the [Cowichan Valley Wilderness Watch](#).
- Contributed to the [Strathcona Park](#) trailhead project on Mount Washington.

- Supported [National Forest Week](#) activities.

### Assist organizations and projects that improve the quality of life in communities where TimberWest operates.

- Donated over \$160,000 to more than 60 community service groups throughout Vancouver Island and in Vancouver.
- Matched employee [United Way](#) donations in addition to direct corporate donations to the United Way.
- Contributed \$10,000 to the [BC Children's Hospital](#) Miracle Network Telethon.
- Of the cash donations made by TimberWest in 2005, 43% were directed to the United Way, 28% to community activities, 9% to educational activities, 10% to health care and safety, 7% to forestry and environment, and 3% to sports and recreation.

### 2006 TARGETS

TimberWest will continue to ensure that its environmental management systems are practical and effective for its timberland contractors to meet the Company's environmental values. The Company will continue its stewardship and water quality programs and maintain certifications. As well, it will improve systems for identifying and managing red-listed species, as identified by the new federal Species At Risk Act, which includes plants, amphibians, invertebrates, birds and mammals, to ensure harvest planning and implementation effectively protects such species.

## STEWARDSHIP

→ Fresh flight: Goshawks require old-growth or mature second-growth timber to thrive, since they primarily hunt under the canopy. The Queen Charlotte goshawk, a subspecies found on Vancouver Island, is red-listed. They are just one of the keystone indicator species TimberWest monitors to determine the overall health of the forest.

### BEST PRACTICES: Sharing work and values with First Nations

Some working relationships accomplish far more than just work. One excellent case in point is the contract between Duncan-based **Khowutzun Forest Services (KFS)** and TimberWest.

A memorandum of understanding (MOU) signed in 2005 by TimberWest and the **Cowichan Tribes** to work together for mutual benefit led to the Company hiring KFS for silviculture and firefighting services on its private timberlands.

"TimberWest and the Cowichan Tribes wish to build a relationship based on trust, mutual support and open communication. Through the MOU we are able to facilitate working opportunities for them, and hiring Khowutzun Forest Services to do work for the Company is just one aspect of that," says TimberWest Manager of Public Affairs and Government Relations Steve Lorimer.

KFS, which employs 24 First Nations people from the Cowichan Valley area, performs a number of duties that help TimberWest maintain the health of the forest on its timberlands. These include brushing and vegetation control so that

crop trees the Company plants get off to a good start, burning woody debris to prepare the land for reforestation and reduce the risk of forest fires, and first response on-the-ground fire suppression.

TimberWest has also set up an arrangement so that KFS is working with an experienced silvicultural contracting company to learn productive, high-quality tree-planting practices.

While all of these services help TimberWest achieve its stewardship goals, they also provide benefits to the local First Nations community.

"Our program in silviculture at this time is a not-for-profit program. Our profits are our workers realizing good-paying employment opportunities that are more than just seasonal," says Cedar Elliott, Assistant Manager with Khowutzun Forest Services.

The new contract with TimberWest has meant the 12-year-old company can diversify its activities and offer year-round employment. As well, KFS employees receive specialized training and experience that can boost their employability in other communities.

But that's not the only mutual benefit arising from the TimberWest/KFS relationship. Using a First Nations company to work in the forest also taps into a reservoir of specialized knowledge and values.

"All of our workers have traditional ecological knowledge. When they are out in the forest, their culture guides them along the same principles that TimberWest likes to see," says Elliott.

"We've always been taught to respect everything out in the forest because it's all interconnected. That's a shared value."

Mutual opportunities: Irvine Canute (left), Cedar Elliott (centre) and Kevin Stevens (right) of Khowutzun Forest Services discuss a brushing and vegetation control project for TimberWest's timberlands.

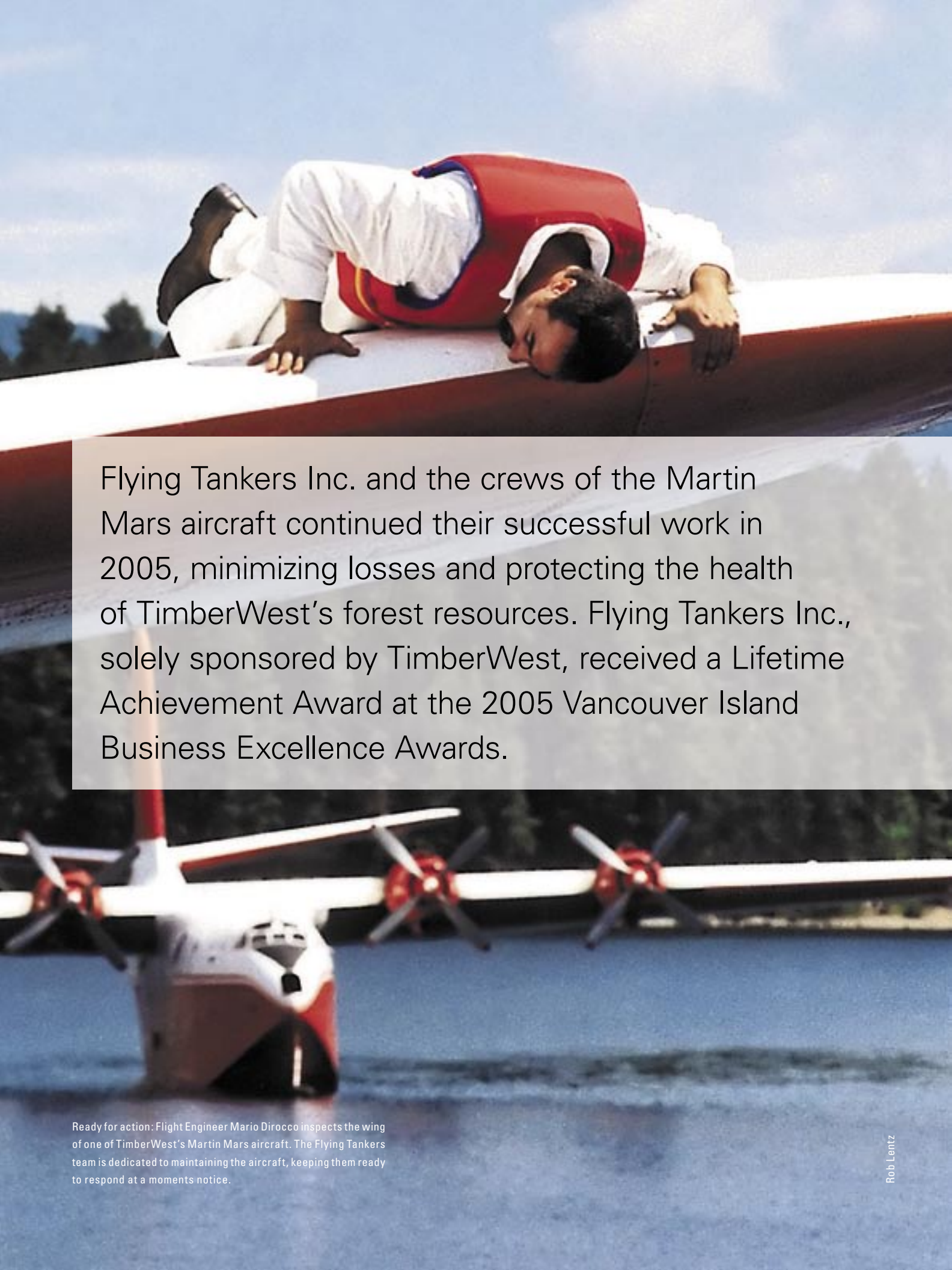






Several young Queen Charlotte goshawks successfully fledged from nests found on TimberWest's private lands during 2005, this one near Cowichan Lake.





Flying Tankers Inc. and the crews of the Martin Mars aircraft continued their successful work in 2005, minimizing losses and protecting the health of TimberWest's forest resources. Flying Tankers Inc., solely sponsored by TimberWest, received a Lifetime Achievement Award at the 2005 Vancouver Island Business Excellence Awards.

Ready for action: Flight Engineer Mario Dirocco inspects the wing of one of TimberWest's Martin Mars aircraft. The Flying Tankers team is dedicated to maintaining the aircraft, keeping them ready to respond at a moments notice.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### CONTENTS

#### Management's Discussion & Analysis

- 32 About TimberWest
- 34 Highlights & Significant Transactions
- 36 Overview of 2005 Performance
- 37 Selected Annual Financial Information
- 39 Results of Operations
- 45 Summary of Financial Position
- 47 Liquidity & Capital Resources
- 48 Off-Balance-Sheet Arrangements
- 49 Future Financial Commitments
- 49 Related Party Transactions
- 50 Analysis of 2005 Fourth Quarter Results
- 51 Quarterly Financial Highlights
- 53 Unit Transactions & Trading Information
- 54 Cash Distributions
- 56 Critical Accounting Policies & Estimates
- 57 Risk Management
- 59 Uncertainties
- 61 Disclosure Controls & Procedures
- 62 Outlook

#### Consolidated Financial Statements

- 63 Management's Responsibility
- 64 Auditors' Report
- 65 Consolidated Statements of Operations & Retained Earnings
- 66 Consolidated Balance Sheets
- 67 Consolidated Statements of Cash Flows
- 68 Notes to Consolidated Financial Statements

## MANAGEMENT'S DISCUSSION & ANALYSIS

Management's discussion and analysis provides an overview of TimberWest Forest Corp.'s business operations, as well as an examination of significant developments that have affected TimberWest's financial condition and results of operations for 2005 relative to 2004. Factors that could affect future operations are also discussed. These factors may be affected by known and unknown risks and uncertainties that may cause the actual future results of TimberWest to be materially different from those expressed or implied in this discussion. This discussion and analysis should be read in conjunction with TimberWest's annual consolidated financial statements and the accompanying notes. TimberWest's annual consolidated financial statements, which include the accounts of TimberWest Forest Corp. and its subsidiaries, are prepared in accordance with Canadian generally accepted accounting principles (GAAP) and are expressed in Canadian dollars. Certain comparative financial figures presented have been reclassified to conform to the presentation adopted in the current year.

Throughout this discussion and analysis reference is made to distributable cash and earnings available for distribution.

Distributable cash and earnings available for distribution are considered key measures by TimberWest in evaluating the Company's operating performance and its ability to meet distribution requirements on its Stapled Units held by unitholders. Distributable cash and earnings available for distribution are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Reconciliations of net earnings and cash flow from operations before changes in working capital, as determined in accordance with GAAP, and earnings available for distribution and distributable cash are provided under "Results of Operations" in this management's discussion and analysis.

This management's discussion and analysis has been prepared based on information available as at February 28, 2006, except where otherwise indicated.

Additional information relating to TimberWest, including the Company's [Annual Information Form](#) and other statutory reports, can be found on the System for Electronic Document Analysis and Retrieval (SEDAR), at [www.sedar.com](http://www.sedar.com).

## MANAGEMENT'S DISCUSSION & ANALYSIS

### ABOUT TIMBERWEST

TimberWest Forest Corp. (TimberWest or the Company) was incorporated on January 31, 1997. In June 1997, the Company acquired the coastal assets of TFL Forest Ltd. (formerly TimberWest Forest Limited), including 210,000 hectares of private timberlands, Crown timber tenures and lumbermill operations, all largely located on Vancouver Island, British Columbia. In December 1997, the Company acquired Pacific Forest Products Ltd.'s 124,000 hectares of private timberlands, also largely located on Vancouver Island.

With its timberland asset base, TimberWest is well positioned as the largest owner of private forest lands in Western Canada. The majority of the Company's 334,000 hectares of private forest lands support the growth of Douglas fir, a premium tree species sought after for structural purposes. While ensuring that rigorous environmental and conservation practices for wildlife, water quality protection, biodiversity conservation and a wide range of other conservation goals are applied, the Company has established that these lands can sustain a long-term harvest of 2.5 million m<sup>3</sup> of logs per year. The Company's external Sustainable Forestry Initiative (SFI®) auditor, KPMG Performance Registrar Inc., has certified the long-term harvest level determination of 2.5 million m<sup>3</sup> and that the Company's analysis meets all SFI® requirements.

TimberWest currently holds renewable long-term public tenures which provide the Company with the right to harvest 0.7 million m<sup>3</sup> of logs per year from Crown lands. The management practices applied to these lands meet the stringent requirements of the Forest Practices Code of British Columbia Act and the Forest and Range Practices Act.

TimberWest also operates a lumbermill at Elk Falls on Vancouver Island that processes lower-value logs primarily sourced from public tenures. The Company initiated a sales process for the lumbermill in late 2005. This process has continued into 2006.

In addition, approximately 6,200 hectares of TimberWest's private forest lands have been identified as having greater value as real estate properties and are progressively being made available for sale.

#### Industry Overview

TimberWest operates exclusively in the solid wood segment of the forest industry, engaged primarily in the harvesting and sale of logs. The Company sells most of its log production on the open market, which provides considerable flexibility to meet market opportunities. In fiscal 2005, the sale of logs accounted for approximately 72% of the Company's revenue.

The forest industry on the BC coast is in a state of transition and has undergone significant change in the regulatory and labour environments. The industry is in the process of getting smaller and some investment is beginning to be made to upgrade existing mills. In 2005, approximately 55% of TimberWest's log sales were to log processing facilities on the BC coast. Therefore a strong, competitive sawmilling industry in this region will favourably

affect the market for both private and public land logs.

In the export market, TimberWest is well positioned to supply fibre to a diverse base of customers who participate in the two largest wood-based housing markets in the world, the United States (US) and Japan. TimberWest's position in the supply chain as a net seller of logs provides the Company considerable flexibility in the harvesting and sale of its timber resources.

#### TimberWest's Vision & Strategy

TimberWest is a market-driven company with a vision of "Growing greatest value through Operations Excellence."

The Company's vision was developed as a result of extensive analyses undertaken in 2001, which included an examination of the competitive dynamics of the forest industry in which TimberWest operates, an assessment of the Company's strengths, weaknesses, opportunities and threats in this industry context, and a determination of the Company's core competencies.

This analysis led to the development of a five-year strategic plan, updated annually, under which TimberWest presently operates. A key conclusion drawn from these analyses was that TimberWest's first priority is to enhance the performance of its existing business units under a strategy focused on "Operations Excellence." Key tenets of Operations Excellence include operating in a safe and sustainable fashion, a strong emphasis on environmental stewardship, and improvements in financial performance through market diversification, cost reductions and strategic silviculture investments.

While all of the Company's operations are integral to the success of each other, strategic objectives have been identified for each area and are described below.

#### TimberWest's Business

##### Private timberlands

Private timberlands refer to the portion of timberland assets that TimberWest owns in fee simple. Private timberland ownership has been an advantage, as the harvesting flexibility has enabled the Company to quickly respond to changing market conditions. Wood harvested from private land is in most cases exportable, albeit with some restrictions, and this has resulted in much higher average sales realizations than those achieved in the domestic market. In addition, these lands have lower operating and regulatory costs than public lands and have a more valuable species mix that is predominantly Douglas fir. As a result, relative to public lands, these lands have generally allowed the Company to generate consistent returns in difficult markets in past years. These returns have been steady, predictable and relatively controllable for TimberWest compared to returns from public lands and log processing.

TimberWest's primary business strategy has been the pursuit of Operations Excellence with its existing basket of assets. As the Company is successful in achieving sustainable reductions in unit costs, it will explore other ways to complement the asset base to



## MANAGEMENT'S DISCUSSION & ANALYSIS

increase value. As a low-cost producer, the Company is now in a position to consider accretive acquisitions.

In June 2004, TimberWest announced a plan to transform its private timberland business model through a restructuring of the Company's log harvesting operations and a move to contract out all logging activities. Historically, 50% of the Company's log harvesting was performed by contractors. Under this transformation plan, the Company contracted the remainder of its logging activities to unionized contractors on a competitive-bid basis, effective January 1, 2005.

The transformation of the Company's logging activities to a contractor model is considered a natural progression of the Company's Operations Excellence strategy, as it is expected to provide increased flexibility, a reduced cost base and an operating structure more closely aligned with industry norms in the rest of North America. This change is expected to improve the Company's competitiveness over the long term. Going forward, the Company's focus will be on core timberland management functions including timber inventory, strategic silviculture investments, harvest planning, and the marketing and sales of timber products.

### Public lands

TimberWest's Crown tenures represent approximately 20% of the total company harvest. These operations have not had consistent profitability since the inception of the Company. The major issue is not only the variability in historic performance but also the uncertainty surrounding future performance in light of both market and regulatory change. Tenure reform, along with ongoing restructuring in the coastal industry, brings uncertainty but also the opportunity that comes with change.

In May 2004, the Company completed the sale of TFL 46 and associated timber licences. Under the agreements for the sale of TFL 46, TimberWest has retained the right to acquire fibre from the purchaser in order to meet obligations under certain fibre supply agreements.

TimberWest is committed to its strategy of Operations Excellence on its remaining public lands. The Company's short- to mid-term focus is on reducing operating costs within public land operations and working with other industry stakeholders to reduce other costs of these operations.

### Lumbermill operations

TimberWest has a single lumber manufacturing facility, the Elk Falls Lumbermill located at Campbell River, BC. The Elk Falls facility includes a lumbermill, an integrated chipping facility, a planer mill and drying kilns. The lumbermill processes medium-diameter logs either harvested from TimberWest's logging operations or traded or purchased specifically for this operation. Operating at three shifts per day, the lumbermill produced 168 million board feet of lumber and 0.3 million m<sup>3</sup> of wood chips in fiscal 2005.

Integral to maximizing the value of the Company's timberland assets is access to conversion facilities that can pay global prices

for fibre. The strategic objective for the Elk Falls Lumbermill is to continue to improve its competitiveness by enhancing and diversifying its product mix to a variety of markets and improving its productivity and cost competitiveness. Being the lowest-cost producer possible will allow the mill to compete with the highest bidders for fibre and thereby help maximize the value of the Company's timberland base. The mill has made progress on increasing productivity and lowering unit costs, but as yet is not globally competitive.

While this sawmill has performed well in the context of the coastal BC industry, as part of a strategic review of TimberWest's assets undertaken in 2005, it was determined that the Elk Falls Lumbermill may have a more logical owner. As a result, early in the fourth quarter of 2005, the Company commenced a sales process for the Elk Falls Lumbermill. This process has continued into 2006.

### Higher-use properties & other revenue streams

TimberWest has a portfolio of higher-use properties that comprise approximately 6,200 hectares at any one time. These properties are identified as TimberWest determines them to have a higher value to other owners. This portfolio has grown since inception, in hectares and in value, but this may not always be the case. Real estate conditions as well as timberland conditions change over time, which can cause the value and size of the higher-use property portfolio to change.

A strategic review of TimberWest's entire land holdings is underway and will be completed in 2006. The objective of this review is to ensure that values are being optimized and that lands are being put to their highest and best economic use, be that commercial forestry or real estate development. Going forward, real estate is expected to play a greater role in delivering value to TimberWest's unitholders than it has in the past.

TimberWest's land holdings also have potential value to be realized from other uses, such as coal bed methane gas and mineral rights.

TimberWest is committed to exploring opportunities to create additional value from its existing land base, including participation in real estate activity and the development of other revenue streams where value may be added.

### Key Performance Drivers

Each year the Company establishes quantifiable performance targets for each of its Operations Excellence principles and communicates progress toward these targets to employees and unitholders on a quarterly basis.

The Company's focus is on improving financial performance. As TimberWest operates in an international commodity market, the Company has separated this objective into two areas of concentration: market diversification and cost reduction.

Under market diversification, the Company's goal is to diversify its markets to maximize the return on every log produced. It strives to achieve this goal by finding the right customer for each log and thereby obtaining the highest value for the Company's timber resources.

## MANAGEMENT'S DISCUSSION & ANALYSIS

In the area of cost reduction, the Company continues to benchmark contractor performance to ensure the Company can achieve the highest efficiency possible in order to place operations in the top quartile of industry performance and to ensure that the Company remains competitive on a global basis.

TimberWest is committed to ensuring that financial returns do not come at the expense of safety and environmental performance. The Company has established performance measures for these matters that are continually monitored to ensure initiatives aimed at improving the Company's return-to-log are carried out by employees and contractors in a safe and sustainable manner.

### Capability to Deliver Results

#### Financial capability

TimberWest is conservatively financed and has a low cost of capital. The Company has a debt-to-total capitalization ratio of 20% and

has considerable financial flexibility in distributing cash to its unit-holder base and for investing in the Operations Excellence strategy where required. Within the past year, the Company accessed the Canadian bank market for refinancing on favourable terms.

#### Non-financial capability

TimberWest has a highly skilled workforce — from its management team and its Board of Directors through to employees and contract crews. During the past year, the Company's management team worked well together and is solidly aligned with TimberWest's strategic direction. The Company also has effective internal control and management information systems that ensure optimal decisions are being made and that relevant and timely information is being disclosed to the capital markets. TimberWest has invested in people, equipment, roads and inventory at appropriate levels to ensure that production can respond to changing market conditions.

## HIGHLIGHTS & SIGNIFICANT TRANSACTIONS

### Business Transformation

In 2004, TimberWest announced a plan to transform its business model through a restructuring of the Company's log harvesting operation and a move to contract out all logging and road building activities. Historically, 50% of the Company's log harvesting was performed by contractors.

The Company began 2005 with all of its harvesting and road building functions contracted out to stump-to-dump operators. Despite challenging weather conditions at the beginning of the year, the transition to a contractor workforce progressed smoothly.

The Company completed the final phase of the business transformation initiative early in 2005. This involved the buyout of leases on Company-operated logging equipment for \$21.0 million, and the subsequent sale of this leased equipment and other Company-owned logging equipment to long-term contractors for proceeds of approximately \$25.1 million. Other income for the year ended December 31, 2005, includes a gain on disposal of logging equipment of approximately \$4.0 million.

This new business model allows the Company to operate with fewer salaried positions. During the second quarter of 2005, the Company recorded a \$2.0 million restructuring charge and eliminated additional salaried positions in the timberland and corporate overhead components of its business. The Company expects that this restructuring will provide savings of \$1.6 million per year.

Going forward, this initiative is expected to result in further cost reductions and improved flexibility, both of which should improve the competitiveness of the organization over time.

### Timber Reallocation Agreement

In March 2005, TimberWest reached an agreement with the Province of British Columbia to compensate the Company for the

loss of logging rights through the timber reallocation process under the Province's Forestry Revitalization Plan. Under the agreement, the Company's Crown tenures were reduced, including a 33,207 m<sup>3</sup> reduction to Tree Farm Licence 47 and a 2,252 hectare reduction to two timber licences held by the Company. These tenures will be reallocated by the Province to community forests, woodlots, First Nations and an expanded BC timber sales program.

In the first quarter of 2005, TimberWest received \$3.7 million in compensation for the loss of logging rights and for improvements made to these areas by the Company, including roads and bridges associated with the areas being reallocated from these tenures.

### Increase in Long-Run Sustainable Harvest

On October 19, 2004, TimberWest announced an increase in the long-run sustainable harvest on its private timberlands, from 2.3 million m<sup>3</sup> to 2.5 million m<sup>3</sup>, on the basis of improvements in the underlying growth rates of the forest inventory due to yield increases from a range of silviculture practices.

During the second quarter of 2005, the Company's external Sustainable Forestry Initiative (SFI®) auditor, KPMG Performance Registrar Inc., completed its assessment of the Company's determination and confirmed that the Company's long-term harvest level determination of 2.5 million m<sup>3</sup> on the Company's private timberlands can be maintained for the next 50 years, after which it declines to 2.36 million m<sup>3</sup>, and that the Company's analysis meets all SFI® requirements.

To improve the value of the Company, TimberWest commenced an initiative in 2005 to further increase the harvest level on its private lands through improved forest management. This year and, markets permitting, over the next three to five years, the Company anticipates increasing private land harvests by about 500,000 m<sup>3</sup>,

## MANAGEMENT'S DISCUSSION & ANALYSIS

to approximately 3.0 million m<sup>3</sup> per year. This additional harvest will come from low-margin, low-productivity stands. Where practicable, these stands will be re-established with better stock while others will be left to regenerate naturally. The Company has run this additional harvest volume through its growth and yield model, which demonstrates that taking low-productivity stands out at a faster rate will have no material effect on the Company's long-run sustainable harvest over the next 50 years.

### Termination of Fibre Supply Agreement

During the third quarter of 2005, TimberWest reached an agreement to terminate a fibre supply agreement with Western Forest Products Inc. for payment of \$15.0 million. This fibre supply agreement was originally entered into in 1997 and required the Company to offer Western Forest Products Inc., in perpetuity, an annual volume of 330,000 m<sup>3</sup> of sawlogs at domestic prices.

This transaction is expected to provide future benefits for the Company as it removes a further encumbrance. With this volume of logs now released for potential export, the Company will be able to achieve maximum value for this fibre in the market.

### Sales Process for Elk Falls Lumbermill

While this lumbermill has performed well in the context of the coastal BC industry, as part of a strategic review of TimberWest's assets undertaken in 2005, it was determined that the Elk Falls Lumbermill may have a more logical owner. As a result, early in the fourth quarter of 2005, the Company commenced a sales process for the lumbermill. This process has continued into 2006.

### Accounting Policy Change

Effective January 1, 2005, TimberWest was required to adopt an amendment to Canadian Institute of Chartered Accountants (CICA) Handbook Section 3860 — Financial Instruments: Disclosure and Presentation. Section 3860 establishes standards for the balance sheet presentation of financial instruments or their components as liabilities or equity. The amendment to Section 3860 requires obligations that may be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. This amendment is effective for the Company's 2005 fiscal year and has been adopted on a retroactive basis, with restatement of amounts in the comparative financial statements.

The amendment to Section 3860 has resulted in a considerable change to the financial statement presentation of the components of the Company's Stapled Unit and the distributions paid

thereon. Despite the effects of this required accounting change, the Company's financial condition and economic underpinnings remain unchanged. In addition, the calculation of distributable cash generated by the Company is not affected by this revision.

The Company's Stapled Units are a unique equity instrument, consisting of one common share, 100 preferred shares and approximately \$8.98 face amount of Series A Subordinate Notes. These components are "stapled" together as a single unit and trade together on the Toronto Stock Exchange as Stapled Units. Components cannot be transferred except with each other as part of a Stapled Unit. The Company has previously classified all components of the Stapled Unit as equity on its balance sheet, as the Subordinate Notes have a "Common and/or Preferred Shares Payment Election." This election provides the Company with the option to satisfy its obligation to pay any interest on the Subordinate Notes by delivering common and/or preferred shares, and with the option to pay the principal amount of the outstanding Subordinate Notes by delivering common shares.

Given that the number of shares required to retire the Subordinate Note component is not fixed, the Series A Subordinate Note component of the Stapled Unit is no longer classified as equity and is now presented as a liability on the Company's consolidated balance sheets. As at December 31, 2005, the Series A Subordinate Note component liability was \$695.7 million (December 31, 2004 — \$690.5 million).

Further, holders of the Company's Stapled Units are entitled to annual interest payments on the Subordinate Note component of approximately \$1.08 per Stapled Unit. For the same reason that the Subordinate Note component was previously classified as equity on the Company's consolidated financial statements, interest payments on Stapled Units have previously been recorded as a distribution to unitholders and charged directly to retained earnings, on an after-tax basis, similar to dividends on common shares. The amendment to Section 3860 requires that the interest on the Series A Subordinate Notes paid to unitholders be reported, on a pre-tax basis, as interest expense in the statement of operations. This revision also requires the tax benefit provided by the distributions to be reported as a component of the income tax provision in the statement of operations.

For the year ended December 31, 2005, interest on the Series A Subordinate Notes of \$83.3 million has been reported as an interest expense in the consolidated statements of operations, whereas for the comparable period in 2004 the interest amount of \$82.5 million and the income tax benefit thereon of \$29.3 million had previously been reported in retained earnings.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### OVERVIEW OF 2005 PERFORMANCE

The year ending December 31, 2005, was a challenging year for TimberWest and for the entire forest industry on the BC coast. Challenges included a stronger Canadian dollar, a weaker log sales mix and rising input costs, all negatively affecting financial results for the year. Consequently, TimberWest generated distributable cash of \$67.3 million in 2005, less than the targeted level for the year.

Despite the financial challenges in 2005, the Company continued to work to further strengthen itself for the future and to position itself as a timberland management company.

Operationally, the Company completed its business transformation initiative early in 2005, successfully concluding the move to fully contracted operations with the transfer of employees and equipment to contractors. The move to this industry model will provide the Company with increased flexibility and a reduced cost structure.

Distributable cash for the year was adversely affected by a \$15.0 million payment to terminate a fibre supply agreement with Western Forest Products Inc. The Company viewed this supply agreement as a material encumbrance on its business which impaired the value of the Company's logs. Going forward, the Company anticipates that the fibre freed up via this transaction will result in improved log sales realizations and added flexibility in its log sales and marketing programs.

On the timberland side of the business, log sales realizations were lower as a result of a weaker end use sort mix, continuing weakness in the domestic sawmilling sector and the strong Canadian dollar, which overshadowed improved US dollar pricing in some of the Company's export markets. The lumbermill realizations were also negatively affected by currency and, through most

of the year, by an oversupplied Japanese lumber market for the products it produces. The result was downward pressure on the Company's overall operating margin, which decreased to 15% from 20% in 2004. In response to these adverse market conditions, the Company shifted its log marketing and sales focus to the export market. Log export volumes were at record levels in 2005, with a 74% increase in volumes sold into the US and a 23% increase in volumes sold into Asian markets compared to 2004. Of particular note are the Company's efforts to develop non-Japan Asian markets, where the Company successfully developed new relationships and more than doubled its year-over-year sales volumes.

The Company continued to focus on cost reduction in 2005. This included a restructuring of salaried positions to better align the Company's organizational structure with its new business model. A restructuring charge of \$2.0 million was recorded in the year, and salaried positions were eliminated in the timberland and corporate overhead components of the business. Going forward, the Company anticipates this restructuring will provide annual cost savings of \$1.6 million.

As part of the Company's objective of becoming a pure play timberland management company, the Company announced a sales process for the sale of the Elk Falls Lumbermill late in 2005. This process has continued into 2006.

Distributable cash generated in 2005 was favourably affected by real estate activities, which generated revenues of \$15.1 million, including proceeds of \$13.9 million from the sale of higher-use properties. Strong real estate revenues for 2005 can be attributed to a shift in strategy implemented mid-year which focused on realizing the benefits of strong markets for real estate on Vancouver Island.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### SELECTED ANNUAL FINANCIAL INFORMATION

The following table presents selected financial information from TimberWest's audited consolidated financial statements for the last three completed fiscal years. This data should be read in conjunction with TimberWest's audited consolidated financial statements for the year ended December 31, 2005, and the accompanying notes. Certain of the prior years' figures have been reclassified to conform to the current year's presentation (see "[Highlights & Significant Transactions — Accounting Policy Change](#)").

<i>(in millions of dollars, except per common share amounts)</i>	<b>2005</b>	2004 (restated)	2003 (restated)
Sales	<b>\$ 458.2</b>	\$ 477.0	\$ 445.4
Earnings (loss) before extraordinary item	<b>\$ 4.8</b>	\$ 14.7	\$ (39.9)
Extraordinary item, net of applicable income taxes	<b>\$ —</b>	\$ 9.0	\$ —
Net earnings (loss)	<b>\$ 4.8</b>	\$ 23.7	\$ (39.9)
Basic and diluted earnings (loss) before extraordinary item per common share	<b>\$ 0.06</b>	\$ 0.19	\$ (0.52)
Extraordinary item, net of applicable income taxes, per common share	<b>\$ —</b>	\$ 0.12	\$ —
Basic and diluted net earnings (loss) per common share	<b>\$ 0.06</b>	\$ 0.31	\$ (0.52)
Total assets	<b>\$ 1,419.1</b>	\$ 1,434.5	\$ 1,440.9
Total long-term financial liabilities	<b>\$ 232.0</b>	\$ 195.0	\$ 195.0
Interest payments on Series A Subordinate Notes held by unitholders	<b>\$ 83.1</b>	\$ 82.3	\$ 82.1

## MANAGEMENT'S DISCUSSION & ANALYSIS

### 2005 vs. 2004

The decrease in sales of \$18.8 million in 2005 was due primarily to a 3% decrease in log sales and a 13% decrease in lumber sales in 2005 compared to 2004. Sale realizations were lower in 2005 as a result of a weaker end use sort mix, a weak domestic market and a stronger Canadian currency, all of which overshadowed improved US dollar pricing in some of the Company's export markets.

Net earnings for 2005 were \$4.8 million, down \$18.9 million from net earnings in 2004. This variance can be attributed to reduced margins on the Company's products due to reduced sales realizations and also reflects the effect of a \$15.0 million payment made during the year to terminate a fibre supply agreement. Net earnings for 2005 also reflect an income tax recovery of \$41.6 million, including a current income tax recovery of \$4.1 million and a non-cash future income tax recovery of \$38.1 million. This compares to an income tax recovery of \$11.9 million for 2004. Net earnings for 2004 include \$14.0 million in proceeds received from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights. This settlement has been accounted for as an extraordinary item, net of \$5.0 million in income taxes effected at statutory tax rates. Net earnings for 2004 also benefited from a \$4.3 million gain on the sale of one of the Company's Crown tenures in that year.

The Company's financial position as at December 31, 2005, was strong and comparable to that as at December 31, 2004. The Company's current ratio was 1.7 at December 31, 2005, up from 1.1 at the end of 2004, while the debt-to-total capitalization ratio at December 31, 2005, was 20.1:79.9, comparable to 19.3:80.7 at the end of 2004. Total asset and long-term financial liability balances remained comparable for both 2005 and 2004. Current ratio and debt-to-total capitalization ratio are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's balance sheet strength and capital structure.

Interest payments on the Series A Subordinate Note component of Stapled Units held by unitholders were consistent at \$1.08 per Stapled Unit for both 2005 and 2004. The increase in the total amount paid reflects an increase in the number of Stapled Units outstanding during 2005 due to the exercise of Stapled Unit options.

### 2004 vs. 2003

The increase in sales of \$31.6 million in 2004 was due primarily to a 29% increase in the volume of lumber sold in 2004 compared to 2003. Global markets for logs and lumber were stronger in 2004, whereas adverse market and economic conditions prevailed throughout 2003 and unfavourably affected sales that year. The increase in lumber sold in 2004 also reflects increased production as the result of capital improvements undertaken in 2003 and the full-year effect of adding a third shift to the mill during 2003.

Earnings before extraordinary item were \$54.6 million higher in 2004 than 2003. This positive variance primarily reflected the effects of improvements in end markets and higher average realizations for both log and lumber sales, as well as a continued focus on operational cost reductions and the resultant effect on cost of sales. Earnings for 2004 also benefited from a \$4.3 million gain on the sale of one of the Company's Crown tenures.

In 2004, the Company received \$14.0 million in proceeds from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley. This settlement has been accounted for as an extraordinary item, net of \$5.0 million in income taxes effected at statutory tax rates.

For the year ended December 31, 2004, the Company generated net earnings of \$23.7 million, compared to a net loss of \$39.9 million for fiscal 2003. As noted above, this year-over-year improvement can be attributed to stronger markets, increased lumber sales, proceeds from the sale of TFL 46 and expropriation settlement proceeds received in 2004.

The Company's financial position as at December 31, 2004, was stronger than as at December 31, 2003, as reflected by year-over-year improvements in the current and debt-to-total capitalization ratios. Total asset and long-term financial liability balances remained comparable for both 2004 and 2003.

Interest payments on the Series A Subordinate Note component of Stapled Units held by unitholders were consistent at \$1.08 per Stapled Unit for both 2004 and 2003. The increase in the total amount paid reflects an increase in the number of Stapled Units outstanding during 2004 due to the exercise of Stapled Unit options.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### RESULTS OF OPERATIONS

#### Distributable Cash

The following table presents distributable cash generated by TimberWest for the year ended December 31, 2005, in comparison to distributable cash generated for the years ended December 31, 2001 through December 31, 2004. Certain of the prior years' figures have been reclassified to conform to the current year's presentation (see "Highlights & Significant Transactions — Accounting Policy Change").

<i>(in millions of dollars except per Stapled Unit amounts)</i>	2005	2004 (restated)	2003 (restated)	2002 (restated)	2001 (restated)
<b>Consolidated Statements of Distributable Cash</b>					
Net earnings (loss)	\$ 4.8	\$ 23.7	\$ (39.9)	\$ (15.8)	\$ 4.1
Interest on Series A Subordinate Notes owned by unitholders	83.3	82.5	82.1	81.8	69.9
Earnings available for distribution <sup>1</sup>	88.1	106.2	42.2	66.0	74.0
Future income tax recovery on earnings before extraordinary item	(38.1)	(12.4)	—	(0.2)	(15.2)
Future income tax expense on extraordinary item	—	5.0	—	—	—
Earnings available for distribution before provision for future income taxes	50.0	98.8	42.2	65.8	58.8
Add (deduct):					
Depreciation, depletion and amortization	9.5	11.2	11.2	15.2	17.0
Proceeds from sale of property, plant and equipment	42.8	33.3	11.4	19.4	12.4
Gain on sale of property, plant and equipment	(13.0)	(12.4)	(3.7)	(3.9)	(2.5)
Additions to property, plant and equipment	(22.6)	(8.5)	(18.0)	(11.5)	(7.3)
Other non-cash items	0.6	2.8	8.3	5.1	5.1
	17.3	26.4	9.2	24.3	24.7
Distributable cash <sup>1</sup>	\$ 67.3	\$ 125.2	\$ 51.4	\$ 90.1	\$ 83.5
Consists of:					
Distributable cash before extraordinary item	\$ 67.3	\$ 111.2	\$ 51.4	\$ 90.1	\$ 83.5
Distributable cash from extraordinary item	—	14.0	—	—	—
	\$ 67.3	\$ 125.2	\$ 51.4	\$ 90.1	\$ 83.5
Reconciliation of cash flows from operations before changes in working capital to distributable cash:					
Cash flow from operations before changes in working capital	\$ (34.5)	\$ 17.4	\$ (30.8)	\$ (5.7)	\$ 4.5
Add (deduct):					
Interest on Series A Subordinate Notes owned by unitholders	83.3	82.5	82.1	81.8	69.9
Proceeds from sale of property, plant and equipment	42.8	33.3	11.4	19.4	12.4
Additions to property, plant and equipment	(22.6)	(8.5)	(18.0)	(11.5)	(7.3)
Other non-cash items	(1.7)	0.5	6.7	6.1	4.0
	\$ 67.3	\$ 125.2	\$ 51.4	\$ 90.1	\$ 83.5
Basic and diluted earnings available for distribution before provision for future income taxes per weighted average Stapled Unit <sup>1</sup>	\$ 0.65	\$ 1.29	\$ 0.55	\$ 0.88	\$ 0.90
Basic distributable cash per weighted average Stapled Unit <sup>1</sup>					
- before extraordinary item	\$ 0.87	\$ 1.46	\$ 0.67	\$ 1.21	\$ 1.29
- from extraordinary item	—	0.18	—	—	—
	\$ 0.87	\$ 1.64	\$ 0.67	\$ 1.21	\$ 1.29
Diluted distributable cash per weighted average Stapled Unit <sup>1</sup>					
- before extraordinary item	\$ 0.87	\$ 1.45	\$ 0.67	\$ 1.20	\$ 1.29
- from extraordinary item	—	0.18	—	—	—
	\$ 0.87	\$ 1.63	\$ 0.67	\$ 1.20	\$ 1.29
Cash distributions paid per Stapled Unit	\$ 1.08	\$ 1.08	\$ 1.08	\$ 1.08	\$ 1.08
Basic weighted average number of Stapled Units outstanding (000's)	77,207	76,524	76,234	74,686	64,984
Diluted weighted average number of Stapled Units outstanding (000's)	77,315	76,629	76,309	74,808	65,128
Stapled Units outstanding at the end of the period (000's)	77,488	76,907	76,246	76,193	64,691

<sup>1</sup> Earnings available for distribution, distributable cash, basic and diluted earnings available for distribution before provision for future income taxes per weighted average Stapled Unit, and basic and diluted distributable cash per weighted average Stapled Unit are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's operating performance.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### Distributable Cash (continued)

Distributable cash includes consolidated earnings before income taxes less cash income taxes, plus depreciation, depletion and amortization, plus proceeds from the sale of property, plant and equipment net of their gain (loss) on sale, less additions to property, plant and equipment and, from time to time, adjustments for other items deemed appropriate by the Board of Directors.

Distributable cash and earnings available for distribution are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that the presentation of these measures will enhance an investor's understanding of the Company's operating performance. Reconciliations of net earnings and cash flow from operations before changes in working capital, as determined in accordance with GAAP, and earnings available for distribution and distributable cash are provided in the preceding table.

TimberWest generated distributable cash of \$67.3 million, or basic and diluted distributable cash of \$0.87 per weighted average Stapled Unit for the year ended December 31, 2005. This compares to distributable cash of \$125.2 million, or basic distributable cash of \$1.64 per weighted average Stapled Unit and diluted distributable cash of \$1.63 per weighted average Stapled Unit for the year ended December 31, 2004. Earnings available for distribution,

before a net future income tax recovery of \$38.1 million, were \$50.0 million or \$0.65 per basic and diluted weighted average Stapled Unit in fiscal 2005. This compares to earnings available for distribution, before a net future income tax recovery of \$7.4 million, of \$98.8 million, or \$1.29 per basic and diluted weighted average Stapled Unit in 2004. The current year decrease in distributable cash and earnings available for distribution before provision for future income taxes of \$57.9 million and \$48.8 million, respectively, is primarily attributable to a \$24.3 million or 26% decrease in operating earnings for 2005 compared to 2004. This unfavourable result reflects in large part lower average sale realizations on both log and lumber sales during 2005 compared to 2004. On the log sales side, a weaker end use sort mix, a weak domestic log market and the continued strengthening of the Canadian dollar were all factors that offset the strength in export pricing. On the lumber sales side, the strong Canadian dollar and oversupplied Japanese lumber markets for the majority of the year were key factors in lower lumber sales realizations. Other factors contributing to this variance in distributable cash include the payment of \$15.0 million in 2005 to terminate a long-term fibre supply agreement and the receipt of \$16.7 million in 2004 as cash proceeds from the sale of TFL 46, as well as the receipt of \$14.0 million in 2004 as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley.

The following table provides a summary of atypical items included in distributable cash reported for each of 2005 and 2004. Adjusting for these amounts provides a normalized view of distributable cash that more closely reflects distributable cash generated from the Company's ongoing operating activities.

<i>(in millions of dollars except per Stapled Unit amounts)</i>	2005	2004
Distributable cash	\$ 67.3	\$ 125.2
Adjust for non-recurring items:		
Proceeds from sale of logging equipment	(25.1)	—
Purchase of leased logging equipment	21.0	—
Termination of fibre supply agreement	15.0	—
Proceeds from prior year income tax assessment appeal	(7.4)	—
Tenure takeback compensation	(3.7)	—
Restructuring charge	2.0	4.6
Proceeds from sale of timber licences, primarily TFL 46	—	(18.1)
Expropriation settlement proceeds	—	(14.0)
Adjusted distributable cash <sup>1</sup>	\$ 69.1	\$ 97.7
Basic adjusted distributable cash per weighted average Stapled Unit <sup>1</sup>	\$ 0.89	\$ 1.28
Diluted adjusted distributable cash per weighted average Stapled Unit <sup>1</sup>	\$ 0.89	\$ 1.27

<sup>1</sup> Adjusted distributable cash and basic and diluted adjusted distributable cash per weighted average Stapled Unit are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's operating performance.

TimberWest distributed \$83.1 million or \$1.08 per Stapled Unit to unitholders in 2005, consistent with distributions made by the Company in 2004. Since TimberWest's inception in July 1997 to the end of 2005, the Company has generated distributable cash of \$664.1 million while paying out \$629.2 million to unitholders to the end of the calendar year. The Company also paid its January 15, 2006 distribution to unitholders of \$20.9 million.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### Earnings

The following table presents the results of TimberWest's operations for the year ended December 31, 2005, in comparison to the results for the years ended December 31, 2001 through December 31, 2004. Certain of the prior years' figures have been reclassified to conform to the current year's presentation (see "Highlights & Significant Transactions — Accounting Policy Change").

<i>(in millions of dollars except per common share amounts)</i>					
	2005	2004 (restated)	2003 (restated)	2002 (restated)	2001 (restated)
<b>Consolidated Statements of Earnings</b>					
Sales	\$ 458.2	\$ 477.0	\$ 445.4	\$ 481.1	\$ 477.8
Operating costs and expenses:					
Cost of sales	365.1	358.0	363.4	366.1	362.2
Selling, administrative and other	14.2	14.5	13.5	14.0	15.0
Depreciation, depletion and amortization	8.8	10.1	9.8	11.5	13.4
	388.1	382.6	386.7	391.6	390.6
Operating earnings	70.1	94.4	58.7	89.5	87.2
Interest expense:					
Series A Subordinate Notes owned by unitholders	83.3	82.5	82.1	81.8	69.9
Long-term debt	14.8	14.3	14.0	1.9	11.3
Short-term debt	1.1	1.9	2.0	13.4	12.1
	99.2	98.7	98.1	97.1	93.3
Amortization of debt issue costs	0.7	1.1	1.4	3.7	3.6
Other (income) expense, net	(8.0)	(8.2)	(1.8)	(0.9)	—
Termination of fibre supply agreement	15.0	—	—	—	—
Loss on bond lock transaction	—	—	—	5.0	—
	106.9	91.6	97.7	104.9	96.9
Earnings (loss) before income taxes and extraordinary item	(36.8)	2.8	(39.0)	(15.4)	(9.7)
Income tax expense (recovery)	(41.6)	(11.9)	0.9	0.4	(13.8)
Earnings (loss) before extraordinary item	4.8	14.7	(39.9)	(15.8)	4.1
Extraordinary item — expropriation settlement proceeds, net of applicable income taxes	—	9.0	—	—	—
Net earnings (loss)	\$ 4.8	\$ 23.7	\$ (39.9)	\$ (15.8)	\$ 4.1
Basic and diluted earnings (loss) before extraordinary item per common share	\$ 0.06	\$ 0.19	\$ (0.52)	\$ (0.21)	\$ 0.06
Extraordinary item, net of applicable income taxes, per common share	—	0.12	—	—	—
Basic and diluted net earnings (loss) per common share	\$ 0.06	\$ 0.31	\$ (0.52)	\$ (0.21)	\$ 0.06

### Sales

Sales for the year ended December 31, 2005, were \$458.2 million, down 4% from \$477.0 million in sales reported for the year ended December 31, 2004.

### Logs

Log sales for the year ended December 31, 2005, were \$327.9 million, or 72% of total sales, compared to \$337.6 million or 71% of total sales for 2004. Log sales were down 3% overall, reflecting the net effect of a 13% decrease in average log sales realizations and an 11% increase in the volume of logs sold relative to 2004.

Total log sales volumes for 2005 were 3.615 million m<sup>3</sup> compared to 3.252 million m<sup>3</sup> in 2004. Domestic log sales volumes of 1.966 million m<sup>3</sup> in 2005 were comparable to volumes of 2.100 million m<sup>3</sup> in 2004, while 2005 export sales volumes increased to 1.649 million m<sup>3</sup>, up 43% compared to 2004. Volumes sold to Asian markets in 2005 of 0.853 million m<sup>3</sup> were up 23% compared to sales for 2004, while volumes sold to US markets in 2005

were 0.796 million m<sup>3</sup>, up 74% compared to 2004. Asian and US markets accounted for 52% and 48% of 2005 export volumes, respectively, compared to 60% and 40% in 2004.

Log sales realizations for 2005 averaged \$91 per m<sup>3</sup> compared to \$104 per m<sup>3</sup> for 2004. Realizations for both domestic and export sales in 2005 were down 17% compared to 2004, with realizations on domestic sales decreasing to \$72 per m<sup>3</sup> and realizations on export sales decreasing to \$113 per m<sup>3</sup>. The weaker domestic log sales realizations in 2005 can be attributed equally to softer pricing in this market during the year and to a weaker end use sort mix into this market compared to 2004. In addition to weaker end use sort mix, currency continued to be a negative factor for export sales realizations in 2005. On average, the Canadian dollar was approximately 7% stronger against its US counterpart during 2005 relative to fiscal 2004. The overall sales mix by species for 2005 was comprised of 55% fir, 28% hemlock and 10% cedar, compared to 59% fir, 22% hemlock and 10% cedar for 2004.



## MANAGEMENT'S DISCUSSION & ANALYSIS

Increased log sales volumes and lower export sales realizations in 2005 both reflect a shift in log marketing and sales efforts and a focus on export markets to compensate for and offset the effects of continued weakness in the domestic market. Export sales realizations are greater than would otherwise be achieved in the domestic market.

### Lumber and wood chips

Lumber sales for the year ended December 31, 2005, were \$92.2 million, or 20% of total sales. This compares to lumber sales of \$106.2 million representing 22% of total sales for fiscal 2004. The 13% decrease in lumber sales reflects an 11% decrease in average lumber sales realizations, falling to \$552 per mfbm from \$619 per mfbm for 2004, as well as a 3% decrease in the volume of lumber sold, falling to 166.9 million board feet for 2005 from 171.7 million board feet for 2004. As with log sales, the decline in lumber sales realizations and sales volumes in 2005 reflects oversupplied lumber markets in Japan, combined with the adverse effects of the stronger Canadian dollar, a factor which ultimately makes Canadian products less competitive compared to other global suppliers. Sales volumes in 2005 were also adversely affected by the fact that there was less volume available for sale compared to 2004 because the Company's lumbermill took five weeks of market-related downtime in the second quarter of 2005.

Wood chip sales for 2005 of \$11.0 million were 12% less than wood chip sales of \$12.5 million in 2004, reflecting an 11% decrease in wood chip volumes sold compared to 2004 and a 3% decrease in average wood chip sales realizations. Wood chips are a by-product of the lumber manufacturing process and, as anticipated, the 2005 decrease in wood chip sales mirrors the 2005 decrease in lumber and chip production, primarily due to the downtime taken at the lumbermill during 2005.

### Real estate

Real estate activities generated revenues of \$15.1 million for the year ended December 31, 2005, compared to revenues of \$10.8 million for 2004. Real estate sales generally vary from year to year, reflecting the variable nature and timing of real estate sales activity. The increase in real estate revenues for 2005 can be attributed to a strategy implemented during the year to realize the benefits of strong markets for real estate on Vancouver Island.

### Operating Earnings

Operating earnings for the year ended December 31, 2005, were \$70.1 million, or 15% of sales, compared to \$94.4 million or 20% of sales for 2004. The 26% year-over-year decrease in operating earnings reflects the effects of considerably lower sales realizations in 2005 for all wood products, which more than offset improvements in operating costs.

On the Company's timberland operations, the operating margin for 2005 was 26%, down 6% from 32% of log sales for 2004, reflecting the effects of the 13% decrease in log sales realizations described previously, offset in part by production cost reductions achieved during 2005. The Company successfully implemented its new business model of fully contracted timberland operations and continued to make progress in achieving cost reductions and increased productivity on its timberland operations. Timberland Operations delivered overall production cost savings of \$2.28 per m<sup>3</sup> in 2005, with logging production costs for the year of \$64 per m<sup>3</sup>, down from \$66 per m<sup>3</sup> in the prior year. Logging production volumes for 2005 were up 7% over 2004, to 3.6 million m<sup>3</sup>. The increased volume in 2005 can be attributed to a strategy implemented mid-year to target low-margin, low-productivity stands. This strategy is described further in "[Highlights & Significant Transactions — Increase in Long-Run Sustainable Harvest.](#)"

The Elk Falls Lumbermill had a challenging year in 2005, reporting an operating loss for the year compared to a positive cash and earnings contribution in 2004. As discussed previously, weak markets and low realizations were the primary contributors to this result. With five weeks of market-related downtime taken in the second quarter of 2005, the lumbermill's production for the year was down 7% compared to 2004, to 167.6 million board feet. Despite higher operating supply costs, including fuel costs, the lumbermill was able to maintain per unit conversion costs at the 2004 levels.

Operating earnings were positively affected by higher-margin real estate activity for the year ended December 31, 2005, contributing \$8.6 million on revenues of \$15.1 million, compared to a \$4.2 million contribution on revenues of \$10.8 million in 2004.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### Earnings Before Interest, Taxes, Depreciation & Amortization

Earnings before interest, taxes, depreciation and amortization (EBITDA) for the year ended December 31, 2005, decreased \$40.8 million to \$71.9 million, compared to \$112.7 million for 2004. On a per weighted average Stapled Unit basis, EBITDA decreased to \$0.93 for 2005, down from \$1.47 in the prior year. For the year ended December 31, 2005, EBITDA as a percentage of sales decreased to 16%, down from 24% for the year ended December 31, 2004. These results were due to factors described previously.

The following table details the calculation of TimberWest's EBITDA for both fiscal 2005 and 2004. Certain of the prior years' figures have been reclassified to conform to the current year's presentation (see "[Highlights & Significant Transactions — Accounting Policy Change](#)").

<i>(in millions of dollars)</i>	2005	2004 (restated)
Net earnings	\$ 4.8	\$ 23.7
Add:		
Interest expense	99.2	98.7
Income tax recovery	(41.6)	(11.9)
Depreciation, depletion and amortization	8.8	10.1
Amortization of debt issue costs	0.7	1.1
Extraordinary item, net of applicable income taxes	—	(9.0)
EBITDA <sup>1</sup>	\$ 71.9	\$ 112.7

<sup>1</sup> EBITDA does not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of this measure will enhance an investor's understanding of the Company's operating performance.

### Finance Charges

Interest expense for the year ended December 31, 2005, was \$99.2 million, comparable to the \$98.7 million reported for the year ended December 31, 2004. As described in "[Highlights & Significant Transactions — Accounting Policy Change](#)," interest expense now includes interest on the Series A Subordinate Note component of the Company's Stapled Units, which for 2005 totalled \$83.3 million, compared to \$82.5 million for 2004. Interest on long-term debt of \$14.8 million for 2005 and \$14.3 million for 2004 is primarily comprised of the interest cost on the \$195.0 million aggregate principal amount of 7% unsecured senior debentures outstanding for both 2005 and 2004. The remaining increase in interest on long-term debt offsets the decrease in interest on short-term debt from 2004, reflecting the move to long-term credit facilities in 2005.

The provision for amortization of debt issue costs of \$0.7 million for the year ended December 31, 2005, was down from \$1.1 million in 2004. The current provision primarily reflects the deferral and amortization of fees associated with the debenture public offerings completed in 2002 and 2003, and the deferral and amortization of fees incurred in connection with the new long-term facilities committed to in 2005.

### Other Income

Other income for the year ended December 31, 2005, was \$8.0 million, compared to \$8.2 million for 2004. Other income is comprised of miscellaneous amounts, including gains and losses on the sale of property, plant and equipment other than higher-use properties and interest income.

### Termination of Fibre Supply Agreement

During 2005, the Company reached an agreement to terminate a fibre supply agreement with Western Forest Products Inc. for payment of \$15.0 million. Additional information on this transaction is provided under "[Highlights & Significant Transactions — Termination of Fibre Supply Agreement](#)."

### Income Taxes

The Company reported an income tax recovery of \$41.6 million for the year ended December 31, 2005, compared to an income tax recovery of \$11.9 million for 2004. These results reflect the change in accounting policy for the Series A Subordinate Notes as described under "[Highlights & Significant Transactions — Accounting Policy Change](#)" effective for fiscal 2005, whereby interest on the Series A Subordinate Note component of the Company's Stapled Units is now reported, on a pre-tax basis, as interest expenses in the statement of operations. Prior to this change, interest on the Subordinate Notes was charged directly to retained earnings, on an after-tax basis, with the tax benefit on these payments reflected in the current income tax provision.

The \$41.6 million income tax recovery for 2005 is primarily non-cash, with the exception of a current income tax recovery of \$4.1 million related to the settlement of an appeal of a prior year income tax assessment and \$0.6 million paid during the year on account of large corporation tax. The remaining \$38.1 million represents a net future income tax recovery comprised primarily of a \$16.1 million future income tax recovery resulting from the implementation of a number of tax planning strategies with respect to the availability of non-capital losses, a \$9.3 million

## MANAGEMENT'S DISCUSSION & ANALYSIS

future income tax recovery resulting from a 1.5% reduction in the British Columbia general corporate income tax rate enacted during the year and \$6.0 million related to adjustments to timberland tax values. The \$11.9 million recovery in 2004 includes current taxes of \$0.5 million relating to large corporation tax and a non-cash net future income tax recovery of \$12.4 million.

### Extraordinary Item

In 2004, TimberWest received \$14.0 million in proceeds from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley and Hitchie Creek areas. These proceeds were accounted for as an extraordinary item in 2004 in the consolidated statements of earnings, net of \$5.0 million in income taxes effected at statutory tax rates. As the Company had non-capital losses carried forward from previous taxation years, no cash income taxes were payable on the proceeds from this settlement. The future income tax recovery before the extraordinary item for 2004 was increased by \$5.0 million to recognize the benefit of the losses utilized and fully offsets the tax expense charged to the extraordinary item.

### Net Earnings

Net earnings for the year ended December 31, 2005, were \$4.8 million, down from \$23.7 million for the year ended December 31, 2004. These results reflect the change in accounting policy for the Series A Subordinate Notes as described under "Highlights & Significant Transactions — Accounting Policy Change" effective for fiscal 2005, whereby interest on the Series A Subordinate Note component of the Company's Stapled Units is now reported on a pre-tax basis as an interest expense in the statement of operations rather than as a direct charge to retained

earnings, on an after-tax basis. The decrease in current year net earnings is due to factors described previously.

For the year ended December 31, 2005, TimberWest reported basic and diluted net earnings per common share of \$0.06. For 2004, basic and diluted net earnings before extraordinary item per common share were \$0.19. The expropriation settlement proceeds of \$14.0 million received in 2004, net of applicable income taxes, contributed \$0.12 per common share, resulting in basic and diluted net earnings per common share of \$0.31 for the year ended December 31, 2004.

### Sensitivities

Markets for TimberWest's products are cyclical and affected by such factors as economic growth, interest rates, foreign exchange rates, construction activity and log and chip trading activities. The majority of the timber harvested from the Company's private timberland is sold at prices set by the Vancouver log market. Pricing in this market is affected by the prices of forest products that are produced from BC coastal logs. TimberWest's earnings are subject to variation in log prices and therefore are subject to variations in forest product prices.

In addition, TimberWest sells a substantial volume of product outside of Canada (59% of sales in 2005), mostly in US dollars. As such, the relative strength of the Canadian dollar versus its US counterpart has an effect on sales and earnings. Results can be adversely affected by a strengthening Canadian dollar. The relative strength of the yen and the euro also affect the Company's competitiveness in the markets where it sells its products. The Company's approach to managing this risk has been to work on reducing costs in an effort to improve its competitiveness on a global basis.

The following table illustrates the sensitivity of TimberWest's operating earnings to changes in the average Canadian dollar selling price for its major products and in the value of the Canadian dollar relative to the US dollar.

<i>(in millions of dollars)</i>	Effect on operating earnings	
Logs — \$5 change per m <sup>3</sup>	\$	18.1
Lumber — \$10 change per mfbm	\$	1.7
Chips — \$5 change per m <sup>3</sup>	\$	1.6
Canadian dollar — \$0.01 US change per Canadian dollar <sup>1</sup>	\$	3.2

<sup>1</sup> Estimate is based on US-dollar denominated sales for the year ending December 31, 2005, assuming all other variables remain constant.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### SUMMARY OF FINANCIAL POSITION

The following table presents summary information on TimberWest's financial position as at December 31, 2005, in comparison to balances as at December 31, 2001 through December 31, 2004. Certain of the prior years' figures have been reclassified to conform to the current year's presentation (see "Highlights & Significant Transactions — Accounting Policy Change").

<i>(in millions of dollars)</i>	<b>2005</b>	2004 (restated)	2003 (restated)	2002 (restated)	2001 (restated)
Current assets	<b>\$ 88.8</b>	\$ 88.0	\$ 70.0	\$ 102.3	\$ 91.6
Property, plant and equipment	<b>1,318.4</b>	1,334.3	1,356.5	1,355.6	1,369.1
Other assets	<b>11.9</b>	12.2	14.4	20.4	26.5
<b>Total assets</b>	<b>\$ 1,419.1</b>	\$ 1,434.5	\$ 1,440.9	\$ 1,478.3	\$ 1,487.2
Current liabilities	<b>\$ 51.0</b>	\$ 78.2	\$ 110.0	\$ 173.0	\$ 262.2
Long-term financial liabilities	<b>232.0</b>	195.0	195.0	130.0	175.0
Other long-term liabilities	<b>216.7</b>	254.2	260.4	260.5	261.5
	<b>499.7</b>	527.4	565.4	563.5	698.7
Series A Subordinate Notes owned by unitholders	<b>695.7</b>	690.5	684.6	684.1	580.8
	<b>1,195.4</b>	1,217.9	1,250.0	1,247.6	1,279.5
Unitholders' equity	<b>223.7</b>	216.6	190.9	230.7	207.7
<b>Total liabilities and unitholders' equity</b>	<b>\$ 1,419.1</b>	\$ 1,434.5	\$ 1,440.9	\$ 1,478.3	\$ 1,487.2

#### Current Assets

Current assets experienced a year-over-year increase of \$0.8 million to \$88.8 million at December 31, 2005, up from \$88.0 million as at December 31, 2004.

Cash and cash equivalents were \$3.0 million at December 31, 2005, compared to \$1.6 million at the end of 2004.

Trade accounts receivable increased to \$23.9 million at December 31, 2005, up from \$14.7 million at the end of 2004, reflecting the effect of a 16% increase in sales during the fourth quarter of 2005 compared to the same period in 2004.

Inventory decreased to \$48.2 million at December 31, 2005, down from \$62.2 million at December 31, 2004. Log inventory value of \$39.3 million at the end of 2005 was \$14.8 million lower than log inventory of \$54.1 million at the end of 2004, reflecting a 19% decrease in log volumes in inventory at the end of 2005 compared to 2004. This decrease represents a drawdown of log inventory to more normal levels at the end of 2005. Lumber inventory value was \$7.5 million at the end of 2005 compared to \$6.8 million at December 31, 2004. This increase reflects both a 5% increase in year-end volumes and a higher-value inventory at the end of 2005.

Prepaid expenses and other current assets were \$11.2 million at December 31, 2005, compared to \$5.7 million at the end of 2004. This increase is primarily attributable to higher amounts related to the increased real estate activity during the fourth quarter of 2005, including amounts receivable on transactions that had closed before the end of the year.

Future income tax assets were \$2.5 million as at December 31, 2005, down slightly from \$3.8 million at the end of 2004.

#### Property, Plant & Equipment

Property, plant and equipment of \$1,318.4 million as at December 31, 2005, were \$15.9 million less than at December 31, 2004, primarily reflecting the sale of real estate properties for proceeds of \$14.5 million during 2005, and the current year provision for depreciation, depletion and amortization of \$8.8 million.

#### Other Assets

Other assets of \$11.9 million as at December 31, 2005, were comparable to the balance of \$12.2 million at the end of the prior year. Other assets are comprised primarily of prepaid pension benefits and deferred debt issue costs.

#### Current Liabilities

Current liabilities at the end of 2005 were \$51.0 million, down \$27.2 million from \$78.2 million as at December 31, 2004. This decrease can be attributed to a decrease in both borrowings on short-term credit facilities and accounts payable and accrued liabilities compared to the prior year.

During 2005, the Company finalized arrangements for new long-term credit facilities to take advantage of the prevailing favourable interest-rate market:

- On July 7, 2005, the Company entered into a long-term financing facility in the amount of \$65.0 million pursuant to an unsecured revolving facility underwritten by a Canadian chartered bank, due on July 7, 2010. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based loans, bankers' acceptances, LIBOR loans and letters of credit or guarantee.

## MANAGEMENT'S DISCUSSION & ANALYSIS

On completion of this facility, the Company's previously outstanding unsecured committed revolving credit facility for \$40.0 million due on July 31, 2005, was cancelled.

- On July 28, 2005, the Company entered into an additional long-term financing facility in the amount of \$100.0 million pursuant to an unsecured revolving facility underwritten by a syndicate of Canadian chartered banks, due on July 27, 2010. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based loans, US base rate-based loans, bankers' acceptances, LIBOR loans and letters of credit or guarantee. On completion of this facility, both the Company's previously outstanding unsecured committed revolving credit facility for \$40.0 million due on September 1, 2005, and unsecured revolving credit facility for \$125.0 million due on December 31, 2006, were cancelled. The \$40.0 million revolving facility that was cancelled had a \$16.0 million bank guarantee facility attached to it. On July 28, 2005, this bank guarantee facility was renewed as a stand-alone facility. The amount of this facility was increased to \$16.3 million, is due on June 30, 2006, and is subject to annual review and renewal.
- On August 8, 2005, the Company entered into a short-term financing facility in the amount of \$10.0 million pursuant to an unsecured demand operating credit facility underwritten by a Canadian chartered bank. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based and US base rate-based loans and are due on demand.

As at December 31, 2005, the Company had no borrowings on its \$10.0 million demand operating credit facility and had commitments of \$15.9 million relating to outstanding letters of credit issued under its \$16.3 million demand bank guarantee facility. Current liabilities as at December 31, 2004, included combined borrowings of \$22.0 million on the two separate \$40.0 million unsecured 364-day revolving credit facilities available at that time.

Accounts payable and accrued liabilities decreased \$5.4 million to \$30.1 million at December 31, 2005. This variance reflects a combination of factors, including reduced stumpage accruals and reduced compensation-related accruals at the end of 2005 under restructuring and incentive programs compared to balances as at December 31, 2004.

The distribution payable at December 31, 2005, of \$20.9 million has increased slightly from the distribution payable of \$20.7 million at December 31, 2004, reflecting a consistent per unit distribution and an increase in the number of Stapled Units outstanding at December 31, 2005, due to the exercise of options for 580,554 Stapled Units during 2005.

### Long-Term Financial Liabilities

Long-term financial liabilities were \$232.0 million as at December 31, 2005, compared to \$195.0 million at the end of 2004. Included in both the 2005 and 2004 balances is \$195.0 million of 7.0% unsecured senior debentures due October 1, 2007.

As noted previously, the Company finalized arrangements for new long-term credit facilities during 2005. The Company's long-term financial liabilities at December 31, 2005, include borrowings of \$37.0 million on available long-term revolving credit facilities, including borrowing of \$7.0 million on its \$65.0 million long-term unsecured revolving facility and borrowing of \$30.0 million on its \$100.0 million long-term unsecured revolving facility.

### Other Long-Term Liabilities

Other long-term liabilities as at December 31, 2005, included a silviculture liability of \$3.2 million, a \$28.6 million liability relating to non-pension post-retirement benefits and a future income tax liability of \$184.9 million.

The long-term silviculture liability increased \$0.4 million during the year from \$2.8 million at the end of 2004, reflecting the net effect of costs incurred during the year and the current year provision for future obligations arising from harvest activity in 2005.

The liability for non-pension post-retirement benefits increased \$1.5 million during the year from \$27.1 million at December 31, 2004, and reflects actuarially updated estimated liabilities as at December 31, 2005.

The future income tax liability decreased \$39.4 million to \$184.9 million at the end of 2005, reflecting a reduction in temporary differences between the net book and tax values of property, plant and equipment. Much of the decrease in 2005 can be attributed to the implementation of tax planning strategies regarding the availability of non-capital losses, which resulted in a \$16.1 million future income tax recovery in the year. In addition, a 1.5% reduction in the British Columbia general corporate income tax rate was enacted during the year, effective July 1, 2005, reducing the combined federal and provincial statutory corporate income tax rate from 35.6% to 34.1% and resulting in a further income tax recovery of \$9.3 million.

### Series A Subordinate Notes Owned by Unitholders

As a result of a change in accounting policy described under "Highlights & Significant Transactions — Accounting Policy Change" effective for fiscal 2005, the Series A Subordinate Note component of the Company's Stapled Units is now presented as a liability on the Company's consolidated balance sheets rather than as an element of unitholders' equity.

## MANAGEMENT'S DISCUSSION & ANALYSIS

As at December 31, 2005, Series A Subordinate Notes owned by unitholders were \$695.7 million, compared to \$690.5 million as at December 31, 2004. The increase in this balance represents the Series A Subordinate Note component of the 580,554 Stapled Units issued during the year.

### Unitholders' Equity

As at December 31, 2005, unitholders' equity was \$223.7 million, compared to \$216.6 million as at December 31, 2004. These balances reflect the change in accounting policy described under "[Highlights & Significant Transactions — Accounting Policy Change](#)" effective for fiscal 2005, whereby the Series A Subordinate

Note component of the Company's Stapled Units is now presented as a liability on the Company's consolidated balance sheets rather than as an element of unitholders' equity.

The \$7.1 million increase for 2005 can be attributed to a combination of factors including net earnings of \$4.8 million for the year; a \$2.0 million increase in share capital as a result of the issuance of 580,554 Stapled Units during the year; and a \$0.3 million increase in contributed surplus relating to stock-based compensation expense on Stapled Option awards.

As at February 28, 2006, the Company had 77,498,302 issued and outstanding Stapled Units and 1,089,986 granted and outstanding Stapled Unit option awards.

## LIQUIDITY & CAPITAL RESOURCES

### Operating

Cash used in operating activities was \$41.6 million for 2005, compared to \$7.4 million provided by operating activities in 2004.

These results reflect the change in accounting policy for the Series A Subordinate Notes as described under "[Highlights & Significant Transactions — Accounting Policy Change](#)" effective for fiscal 2005, whereby interest on the Series A Subordinate Note component of the Company's Stapled Units are now presented as a use of cash flows under operating activities rather than as a use of cash flows under financing activities. Cash provided by operating activities before distributions to unitholders for 2005 and 2004 was \$48.8 million and \$99.9 million, respectively.

Cash used in operating activities, before changes in non-cash working capital, was \$34.5 million in 2005, compared to cash provided by operating activities, before changes in non-cash working capital, of \$17.4 million in 2004. Non-cash working capital increased \$7.1 million during 2005, compared to a \$10.0 million increase in 2004. The current year increase can be attributed to the net effect of factors discussed previously under "[Summary of Financial Position](#)," including an increase in accounts receivable, prepaid expenses and other current assets, and a decrease in accounts payable and accrued liabilities, offset in part by a decrease in inventory compared to balances at the end of 2004.

### Financing

Cash provided by financing activities was \$22.1 million for the year ended December 31, 2005, compared to \$30.3 million used in financing activities for the year ended December 31, 2004.

Financing activities in 2005 included the issuance of 580,554 Stapled Units on the exercise of Stapled Unit options for net proceeds of \$7.1 million, compared to the issuance of 660,895 Stapled Units for net proceeds of \$7.7 million on the exercise of options during the prior year.

During 2005, the Company increased its borrowings on available revolving credit facilities by \$15.0 million, whereas in 2004 the Company applied \$38.0 million to reduce amounts borrowed on available revolving credit facilities.

### Investing

Cash provided by investing activities was \$20.9 million for the year ended December 31, 2005, compared to \$24.5 million for the year ended December 31, 2004.

Proceeds from the sale of property, plant and equipment during fiscal 2005 were \$42.8 million, compared to \$33.3 million for the prior year. Approximately 60% (\$25.2 million) of the proceeds received in 2005 related to the sale of Company-leased and Company-owned logging equipment to the Company's long-term contractors as part of the business transformation initiative. Proceeds in 2005 also included \$13.9 million cash proceeds from the sale of real estate properties and \$3.7 million received as compensation as part of the Province of British Columbia's timber reallocation process. Proceeds from the sale of property, plant and equipment in 2004 included \$16.2 million received from the sale of TFL 46 and \$10.4 million received on the sale of real estate properties.

Additions to property, plant and equipment for the year ended December 31, 2005, were \$22.6 million, compared to \$8.5 million for 2004. The bulk (\$21.0 million) of the 2005 capital additions can be attributed to the buyout of leases on Company-operated logging equipment as part of the business transformation initiative. The remainder of 2005 additions relate to timberland operations road building activities. Capital additions in 2004 included \$3.5 million for road building activities for timberland operations, \$2.0 million for capital improvements at the Elk Falls Lumbermill and \$2.0 million for a new financial reporting system. For 2006, the Company has committed to approximately \$6.7 million in capital expenditures, including



## MANAGEMENT'S DISCUSSION & ANALYSIS

\$3.5 million for timberland operations road building activities and \$2.2 million for information systems improvements.

Changes in other assets resulted in a net cash inflow of \$0.7 million during 2005, compared to a net cash outflow of \$0.3 million in 2004. Other assets include several balances, many of which are non-cash items, including prepaid pension benefits, deferred financing fees and deferred stock-based compensation, for which changes are not reflected in this line of the consolidated statements of cash flows.

### Capital Resources

Excluding credit facilities and the distribution payable to unit-holders, net operating working capital was \$58.7 million as at December 31, 2005, compared to \$52.5 million as at December 31, 2004. TimberWest believes that its operating working capital is adequate to meet its operating requirements.

Total debt as at December 31, 2005, was \$232.0 million, compared to \$217.0 million as at December 31, 2004.

During 2005, the Company finalized arrangements for new credit facilities to take advantage of the favourable interest market. Total credit facilities available to the Company as at December 31, 2005, were \$386.3 million, comprised of \$10.0 million available under the demand operating credit facility, \$16.3 million available under the demand bank guarantee facility due June 30,

2006, \$65.0 million available under the revolving facility due July 7, 2010, \$100.0 million available under the revolving facility due July 27, 2010, and \$195.0 million of 7.0% debentures maturing on October 1, 2007.

These sources of borrowing, coupled with cash from operations, are sufficient to support the Company's working capital requirements, to finance capital expenditures and to pay required distributions to unitholders.

TimberWest's consolidated debt-to-total capitalization ratio as at December 31, 2005, was 20.2:79.8, compared to the ratio of 19.3:80.7 as at December 31, 2004.

Credit ratings for the Company have been established by Standard and Poor's at BB+ and by Dominion Bond Rating Service at BBB (high) as at December 31, 2005. These ratings did not change during 2005. The Company believes that the strength of its balance sheet and its cash flows from operations will be sufficient to maintain these credit ratings.

Operating working capital, total debt and debt-to-total capitalization ratio are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's financial resources and capital structure.

## OFF-BALANCE-SHEET ARRANGEMENTS

TimberWest does not have derivative financial instruments and does not have any equity interests in unconsolidated entities or any other business arrangements related to the foregoing that would have a material effect on the assets and liabilities of the Company. The Company does not enter into off-balance-sheet arrangements with special purpose entities in the normal course of business. The only significant off-balance-sheet arrangements are commitments under operating lease agreements as discussed under "Future Financial Commitments" in this management's discussion and analysis.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### FUTURE FINANCIAL COMMITMENTS

As disclosed in [note 16](#) of the annual consolidated financial statements, in accordance with GAAP, TimberWest has commitments that are not reflected in the consolidated balance sheets of the Company. These commitments include operating leases for equipment and office premises and letters of credit that are routinely

issued on behalf of insurance companies and other third parties in connection with outstanding performance contracts. As at December 31, 2005, commitments not reflected in the Company's consolidated balance sheets amounted to \$19.9 million.

The following table provides a summary of the Company's future financial commitments as at December 31, 2005. This table details payments due in each of the next five years and thereafter, including commitments reflected on the Company's consolidated balance sheets and those that have not been reflected on the Company's consolidated balance sheets.

<i>(in millions of dollars)</i>	2006	2007	2008	2009	2010	2011+	Total
<b>Reflected on the consolidated balance sheets:</b>							
Revolving credit facilities	\$ -	\$ -	\$ -	\$ -	\$ 37.0	\$ -	\$ 37.0
Debentures	-	195.0	-	-	-	-	195.0
	-	195.0	-	-	37.0	-	232.0
<b>Not reflected on the consolidated balance sheets:</b>							
Obligations under operating leases	1.0	0.9	0.7	0.7	0.6	0.1	4.0
Outstanding letters of credit	15.9	-	-	-	-	-	15.9
	16.9	0.9	0.7	0.7	0.6	0.1	19.9
	\$ 16.9	\$ 195.9	\$ 0.7	\$ 0.7	\$ 37.6	\$ 0.1	\$ 251.9

### RELATED PARTY TRANSACTIONS

TimberWest's consolidated financial statements include the accounts of TimberWest Forest Corp. and its subsidiaries. Intercompany transactions and balances between companies and divisions owned by the Company are eliminated upon consolidation. There are no other such transactions to report.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### ANALYSIS OF 2005 FOURTH QUARTER RESULTS

TimberWest generated distributable cash of \$29.7 million or basic and diluted distributable cash of \$0.38 per weighted average Stapled Unit for the three months ended December 31, 2005, compared to \$18.1 million or basic and diluted distributable cash of \$0.24 per weighted average Stapled Unit for the same period in 2004. The positive variance in distributable cash from the prior year period can primarily be attributed to higher operating earnings in the fourth quarter of 2005, as a result of higher log sales volumes. Proceeds from the sale of real estate for the quarter were \$9.7 million compared to \$7.5 million for the same period in 2004.

Earnings available for distribution, before provision for future income taxes, for the fourth quarter of 2005 were \$24.3 million or \$0.31 per basic and diluted weighted average Stapled Unit compared to earnings available for distribution, before provision for future income taxes, of \$13.2 million or \$0.17 per basic and diluted weighted average Stapled Unit for the same quarter in 2004.

Sales for the fourth quarter of 2005 were \$132.8 million, greater than sales of \$114.9 million reported for the fourth quarter of 2004.

Log sales for the three months ended December 31, 2005, were \$88.8 million, up 20% over log sales for the three months ended December 31, 2004. This increase reflects the combined effects of higher log sales volumes, totalling 990,100 m<sup>3</sup>, and lower log sales realizations, averaging \$90 per m<sup>3</sup>. Log sales volumes into all markets were greater than for the comparative period in 2004; most noteworthy was a 76% increase in log volumes sold into export markets, with domestic sales volumes up 16%. Increased export sales volumes in the current quarter reflect the Company's ongoing efforts in seeking opportunities in export markets to offset weakness in the domestic market. Overall log sales realizations for the quarter were down compared to the same period in 2004, with domestic realizations off 13% and export market realizations off 14%. Export realizations continue to be negatively affected by the strength of the Canadian dollar. The Canadian dollar was approximately 4% stronger relative to the US dollar during the fourth quarter of 2005 compared to the fourth quarter of 2004.

Lumber sales for the three months ended December 31, 2005, of \$28.1 million were comparable to sales of \$28.5 million for the fourth quarter of 2004, reflecting the net effect of improved lumber sales realizations and lower sales volumes compared to the same period in 2004.

Wood chip sales for the three months ended December 31,

2005, were \$3.0 million, lower than for the comparative period in 2004. Fourth quarter 2005 results reflect a change in mix, with more lower-value fir chips sold on a comparable volume.

Real estate activity for the fourth quarter of 2005 generated revenues of \$10.2 million compared to revenues of \$7.4 million for the fourth quarter of 2004. These results reflect the Company's efforts to realize the benefits of strong markets for real estate on Vancouver Island.

Operating earnings were \$21.0 million compared to \$15.0 million for the same period in 2004, with the current year operating margin improving to 16%, up from 13% in 2004, reflecting the effect of the higher margins realized on the increased real estate sales for the current year.

The timberland operations' operating margin for the quarter averaged 21% of log sales, compared to the margin of 24% for the comparative period in 2004. This decrease can be attributed to lower average sales realizations for the quarter, which more than offset production cost improvements resulting from lower stumpage and reduced road building activity compared to the prior year period.

The Elk Falls Lumbermill made a positive earnings contribution in the fourth quarter of 2005, comparable to that of the prior year period. Higher average sales realizations prevailed in the quarter, more than offsetting the effects of lower sales volumes compared to the prior year period.

EBITDA for the three months ended December 31, 2005, were \$26.5 million or \$0.34 per basic and diluted weighted average Stapled Unit, compared to \$20.1 million or \$0.26 per basic and diluted weighted average Stapled Unit for the same period in 2004.

The Company reported an income tax recovery of \$31.6 million for the three months ended December 31, 2005. This recovery is primarily non-cash, with the exception of a current income tax recovery of \$4.1 million related to the settlement of an appeal of a prior year income tax assessment. The remainder is related to \$27.5 million future income tax recovery, including a \$16.1 million future income tax recovery resulting from the implementation of a number of tax planning strategies with respect to the availability of non-capital losses.

Net earnings for the three months ended December 31, 2005, were \$30.9 million or basic and diluted net earnings of \$0.40 per weighted average common share, compared to a net loss of \$1.2 million or a basic and diluted net loss of \$0.02 per weighted average common share for the same period in 2004.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### QUARTERLY FINANCIAL HIGHLIGHTS

The following table presents selected unaudited quarterly financial information for each of the Company's last eight quarters. This data has been derived from unaudited interim consolidated financial statements that have been prepared on the same basis as the annual audited consolidated financial statements and, in the Company's opinion, include all normal recurring adjustments necessary for the fair presentation of such information. These unaudited quarterly highlights should be read in conjunction with the Company's audited annual consolidated financial statements. Certain of the prior years' figures have been reclassified to conform to the current year's presentation (see "Highlights & Significant Transactions — Accounting Policy Change").

Unaudited (in millions of dollars except per common share and per Stapled Unit amounts)	2005					2004 (restated)				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
Sales	\$ 98.6	\$ 107.6	\$ 119.2	\$ 132.8	\$ 458.2	\$ 105.4	\$ 136.8	\$ 119.9	\$ 114.9	\$ 477.0
Operating earnings	\$ 17.3	\$ 17.8	\$ 14.0	\$ 21.0	\$ 70.1	\$ 28.0	\$ 28.4	\$ 23.0	\$ 15.0	\$ 94.4
Earnings (loss) before extraordinary item	\$ (2.4)	\$ (6.7)	\$ (17.0)	\$ 30.9	\$ 4.8	\$ 3.8	\$ 8.5	\$ 3.6	\$ (1.2)	\$ 14.7
Extraordinary item, net of applicable income taxes	—	—	—	—	—	—	—	9.0	—	9.0
Net earnings (loss)	\$ (2.4)	\$ (6.7)	\$ (17.0)	\$ 30.9	\$ 4.8	\$ 3.8	\$ 8.5	\$ 12.6	\$ (1.2)	\$ 23.7
Earnings available for distribution <sup>1</sup>	\$ 18.4	\$ 14.1	\$ 3.8	\$ 51.8	\$ 88.1	\$ 24.4	\$ 29.1	\$ 33.2	\$ 19.5	\$ 106.2
Earnings available for distribution before provision for future income taxes	\$ 19.6	\$ 13.0	\$ (6.9)	\$ 24.3	\$ 50.0	\$ 23.6	\$ 29.0	\$ 33.0	\$ 13.2	\$ 98.8
Distributable cash <sup>1</sup> before extraordinary item	\$ 23.9	\$ 15.4	\$ (1.7)	\$ 29.7	\$ 67.3	\$ 27.7	\$ 43.5	\$ 21.9	\$ 18.1	\$ 111.2
Distributable cash from extraordinary item	—	—	—	—	—	—	—	14.0	—	14.0
Distributable cash	\$ 23.9	\$ 15.4	\$ (1.7)	\$ 29.7	\$ 67.3	\$ 27.7	\$ 43.5	\$ 35.9	\$ 18.1	\$ 125.2
Distributions paid	\$ 20.7	\$ 20.8	\$ 20.8	\$ 20.8	\$ 83.1	\$ 20.5	\$ 20.6	\$ 20.6	\$ 20.6	\$ 82.3
<b>\$ per common share<sup>2</sup></b>										
Basic and diluted earnings (loss) before extraordinary item	\$ (0.03)	\$ (0.09)	\$ (0.22)	\$ 0.40	\$ 0.06	\$ 0.05	\$ 0.11	\$ 0.05	\$ (0.02)	\$ 0.19
Extraordinary item, net of applicable income taxes	—	—	—	—	—	—	—	0.11	—	0.12
Basic and diluted net earnings (loss)	\$ (0.03)	\$ (0.09)	\$ (0.22)	\$ 0.40	\$ 0.06	\$ 0.05	\$ 0.11	\$ 0.16	\$ (0.02)	\$ 0.31
<b>\$ per Stapled Unit<sup>2</sup></b>										
Basic and diluted earnings available for distribution <sup>1</sup>	\$ 0.24	\$ 0.18	\$ 0.05	\$ 0.67	\$ 1.14	\$ 0.32	\$ 0.38	\$ 0.43	\$ 0.25	\$ 1.39
Basic and diluted earnings available for distribution before provision for future income taxes	\$ 0.25	\$ 0.17	\$ (0.09)	\$ 0.31	\$ 0.65	\$ 0.31	\$ 0.38	\$ 0.43	\$ 0.17	\$ 1.29
Distributable cash <sup>1</sup> before extraordinary item	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.87	\$ 0.36	\$ 0.57	\$ 0.29	\$ 0.24	\$ 1.46
- basic	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.87	\$ 0.36	\$ 0.57	\$ 0.29	\$ 0.24	\$ 1.45
- diluted	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.87	\$ 0.36	\$ 0.57	\$ 0.29	\$ 0.24	\$ 1.45
Distributable cash from extraordinary item	—	—	—	—	—	—	—	0.18	—	0.18
- basic	—	—	—	—	—	—	—	0.18	—	0.18
- diluted	—	—	—	—	—	—	—	0.18	—	0.18
Distributable cash	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.87	\$ 0.36	\$ 0.57	\$ 0.47	\$ 0.24	\$ 1.64
- basic	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.87	\$ 0.36	\$ 0.57	\$ 0.47	\$ 0.24	\$ 1.63
- diluted	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.87	\$ 0.36	\$ 0.57	\$ 0.47	\$ 0.24	\$ 1.63
Distributions paid	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 1.08	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 1.08

## MANAGEMENT'S DISCUSSION & ANALYSIS

### QUARTERLY FINANCIAL HIGHLIGHTS (CONTINUED)

<i>Unaudited</i>		2005					2004 (restated)													
		Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total									
Sales by product																				
<i>(in millions of dollars)</i>																				
Logs	\$	72.6	\$	80.1	\$	86.4	\$	88.8	\$	327.9	\$	79.3	\$	103.2	\$	81.3	\$	73.8	\$	337.6
Lumber		18.6		22.6		22.9		28.1		92.2		20.0		27.3		30.4		28.5		106.2
Wood chips and other		5.5		4.3		7.5		5.7		23.0		5.1		6.1		6.0		5.2		22.4
Real estate		1.9		0.6		2.4		10.2		15.1		1.0		0.2		2.2		7.4		10.8
	\$	98.6	\$	107.6	\$	119.2	\$	132.8	\$	458.2	\$	105.4	\$	136.8	\$	119.9	\$	114.9	\$	477.0
Sales volume																				
Logs (million m³)																				
Domestic		0.5		0.4		0.6		0.5		2.0		0.5		0.7		0.5		0.4		2.1
Japan and other Asian markets		0.2		0.2		0.2		0.2		0.8		0.2		0.2		0.1		0.2		0.7
United States		0.1		0.2		0.2		0.3		0.8		0.1		0.1		0.2		0.1		0.5
		0.8		0.8		1.0		1.0		3.6		0.8		1.0		0.8		0.7		3.3
Lumber (mmfbm)		35.0		41.1		42.9		47.9		166.9		32.0		39.1		46.6		54.0		171.7
Production volume																				
Logs (million m³)																				
		0.7		1.0		1.1		0.8		3.6		0.9		1.0		0.8		0.7		3.4
Lumber (mmfbm)		46.9		29.2		47.4		44.1		167.6		40.2		43.0		48.4		49.1		180.7

<sup>1</sup> Earnings available for distribution, distributable cash and basic and diluted earnings available for distribution and distributable cash per weighted average Stapled Unit are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that presentation of these measures will enhance an investor's understanding of the Company's operating performance.

<sup>2</sup> Per common share and per Stapled Unit amounts for the year may not equal the sum of the quarters.

The Company generally experiences some seasonal fluctuation in quarterly results due to weather-related factors having an effect on harvesting operations. Earnings in the second half of the year generally trend lower as the result of fire season shutdowns and increased costs of harvesting at higher elevations late in the year due to difficult terrain.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### UNIT TRANSACTIONS & TRADING INFORMATION

The following table sets forth quarterly closing prices and trading volumes of TimberWest's Stapled Unit and equivalent as traded on the Toronto Stock Exchange.

Trading of Stapled Units & equivalent		Closing high	Closing low	Close	Volume
<b>Trust Units/Stapled Units<sup>1</sup>:</b>					
1997:	Third Quarter <sup>2</sup>	\$ 16.00	\$ 11.40	\$ 15.00	8,046,941
	Fourth Quarter	\$ 15.50	\$ 9.90	\$ 10.35	2,893,451
1998:	First Quarter	\$ 11.60	\$ 9.55	\$ 10.50	9,786,692
	Second Quarter	\$ 10.65	\$ 8.20	\$ 8.70	9,790,361
	Third Quarter <sup>1</sup>	\$ 9.00	\$ 7.60	\$ 7.85	4,271,934
	Fourth Quarter	\$ 10.00	\$ 7.30	\$ 8.95	8,486,269
1999:	First Quarter	\$ 9.45	\$ 8.50	\$ 9.30	6,915,090
	Second Quarter	\$ 11.75	\$ 9.15	\$ 11.50	5,498,035
	Third Quarter	\$ 12.00	\$ 10.55	\$ 10.65	5,139,614
	Fourth Quarter	\$ 10.85	\$ 9.25	\$ 9.50	8,047,352
2000:	First Quarter	\$ 10.35	\$ 8.80	\$ 9.25	5,567,211
	Second Quarter	\$ 11.30	\$ 9.10	\$ 10.40	4,094,791
	Third Quarter	\$ 11.15	\$ 9.85	\$ 10.80	4,191,406
	Fourth Quarter	\$ 11.00	\$ 10.00	\$ 10.85	2,231,067
2001:	First Quarter	\$ 11.15	\$ 10.60	\$ 10.90	3,909,883
	Second Quarter	\$ 12.50	\$ 10.80	\$ 12.20	2,430,870
	Third Quarter	\$ 12.54	\$ 11.65	\$ 11.65	3,167,729
	Fourth Quarter	\$ 13.25	\$ 11.50	\$ 13.00	4,834,500
2002:	First Quarter	\$ 13.71	\$ 12.75	\$ 13.33	8,450,000
	Second Quarter	\$ 14.00	\$ 12.65	\$ 13.96	5,766,665
	Third Quarter	\$ 13.95	\$ 12.50	\$ 12.50	8,044,773
	Fourth Quarter	\$ 12.81	\$ 11.20	\$ 12.00	5,614,688
2003:	First Quarter	\$ 12.75	\$ 11.75	\$ 12.34	4,920,579
	Second Quarter	\$ 12.90	\$ 11.11	\$ 11.30	13,497,139
	Third Quarter	\$ 12.20	\$ 11.09	\$ 11.60	12,532,446
	Fourth Quarter	\$ 12.79	\$ 11.18	\$ 12.70	10,859,497
2004:	First Quarter	\$ 13.00	\$ 12.05	\$ 12.85	18,155,492
	Second Quarter	\$ 13.84	\$ 12.50	\$ 13.42	7,531,430
	Third Quarter	\$ 14.46	\$ 12.85	\$ 14.00	6,941,136
	Fourth Quarter	\$ 15.19	\$ 13.40	\$ 15.08	8,726,965
2005:	First Quarter	\$ 16.14	\$ 14.40	\$ 14.78	8,979,721
	Second Quarter	\$ 15.35	\$ 14.06	\$ 14.73	6,019,473
	Third Quarter	\$ 16.25	\$ 14.20	\$ 15.11	9,294,569
	Fourth Quarter	\$ 15.89	\$ 13.20	\$ 15.40	14,321,264

<sup>1</sup> Trust Units of TimberWest Timber Trust ceased to be listed on the Toronto Stock Exchange (TSX) on October 9, 1998. Stapled Units of TimberWest Forest Corp. were listed on the TSX on October 6, 1998. Between October 2, 1998 and July 14, 1999, the Trust Units of the Trust were redeemable for Stapled Units of TimberWest on a one-for-one basis. On July 14, 1999, all remaining Trust Units except for 100 units held by TimberWest Forest Corp. were redeemed for Stapled Units.

<sup>2</sup> Trust Units were listed on the TSX on June 23, 1997.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### CASH DISTRIBUTIONS

TimberWest's policy is to make quarterly distributions to its unit-holders in the form of interest on the Series A Subordinate Note component of the Company's Stapled Units held by unitholders. Quarterly distributions will be payable to the holders of Stapled Units of record on January 1, April 1, July 1 and October 1 in each year (Record Date) and are expected to be paid on the 15th day of the month of each Record Date. The Company may also make distributions as a return of capital upon the redemption of the preferred shares, or as dividends on the common shares or preferred shares. The amounts of such distributions are subject to TimberWest's overall financial condition.

Due to the nature of TimberWest's business, quarterly cash flows will fluctuate during the year for seasonal reasons. Cash flows will also fluctuate from year to year due to the cyclical

nature of the business and currency fluctuations. One of the objectives of TimberWest's cash distribution policy is to make even distributions to unitholders. This means that cash distributions may vary from the actual cash generated during certain periods. Any difference will be added to or subtracted from either cash reserves or available credit facilities.

Total distributions paid to unitholders for the year ended December 31, 2005, were \$83.1 million or \$1.08 per Stapled Unit outstanding at each Record Date and were comprised entirely of interest earned on Series A Subordinate Notes. Since the Company's inception in July 1997 to the end of 2005, the Company has generated distributable cash of \$664.1 million and, including the January 15, 2006 distribution of \$20.9 million, the Company has distributed \$650.1 million to unitholders.

The following table details the composition of distributions paid to date on a per unit and equivalent basis.

Record date	Payment date	Interest income	Taxable dividends	Non-taxable <sup>1</sup>	Total distribution <sup>2</sup>
<b>Trust Units:</b>					
Sep. 30, 1997	Oct. 15, 1997	\$ 0.259000	\$ 0.066000	\$ –	\$ 0.325000
Dec. 31, 1997	Jan. 15, 1998	0.161000	–	0.089000	0.250000
		\$ 0.420000	\$ 0.066000	\$ 0.089000	\$ 0.575000
Mar. 31, 1998	Apr. 15, 1998	\$ 0.266000	\$ –	\$ –	\$ 0.266000
June 30, 1998	July 15, 1998	0.270000	–	–	0.270000
Sep. 30, 1998	Oct. 15, 1998	0.272000	–	–	0.272000
Dec. 31, 1998	Jan. 15, 1999	0.269457	–	–	0.269457
		\$ 1.077457	\$ –	\$ –	\$ 1.077457
Mar. 31, 1999	Apr. 15, 1999	\$ 0.269364	\$ –	\$ –	\$ 0.269364
June 30, 1999	July 15, 1999	0.269364	–	–	0.269364
		\$ 0.538728	\$ –	\$ –	\$ 0.538728
<b>Stapled Units:</b>					
Jan. 1, 1999	Jan. 15, 1999	\$ 0.269457	\$ –	\$ –	\$ 0.269457
Apr. 1, 1999	Apr. 15, 1999	0.269364	–	–	0.269364
July 1, 1999	July 15, 1999	0.269364	–	–	0.269364
Oct. 1, 1999	Oct. 15, 1999	0.269364	–	–	0.269364
		\$ 1.077549	\$ –	\$ –	\$ 1.077549
Jan. 1, 2000	Jan. 15, 2000	\$ 0.269364	\$ –	\$ –	\$ 0.269364
Apr. 1, 2000	Apr. 15, 2000	0.269364	–	–	0.269364
July 1, 2000	July 15, 2000	0.269364	–	–	0.269364
Oct. 1, 2000	Oct. 15, 2000	0.269364	–	–	0.269364
		\$ 1.077456	\$ –	\$ –	\$ 1.077456
Jan. 1, 2001	Jan. 15, 2001	\$ 0.269364	\$ –	\$ –	\$ 0.269364
Apr. 1, 2001	Apr. 15, 2001	0.269364	–	–	0.269364
July 1, 2001	July 15, 2001	0.269364	–	–	0.269364
Oct. 1, 2001	Oct. 15, 2001	0.269364	–	–	0.269364
		\$ 1.077456	\$ –	\$ –	\$ 1.077456
Jan. 1, 2002	Jan. 15, 2002	\$ 0.269364	\$ –	\$ –	\$ 0.269364
Apr. 1, 2002	Apr. 15, 2002	0.269364	–	–	0.269364
July 1, 2002	July 15, 2002	0.269364	–	–	0.269364
Oct. 1, 2002	Oct. 15, 2002	0.269364	–	–	0.269364
		\$ 1.077456	\$ –	\$ –	\$ 1.077456
Jan. 1, 2003	Jan. 15, 2003	\$ 0.269364	\$ –	\$ –	\$ 0.269364
Apr. 1, 2003	Apr. 15, 2003	0.269364	–	–	0.269364
July 1, 2003	July 15, 2003	0.269364	–	–	0.269364
Oct. 1, 2003	Oct. 15, 2003	0.269364	–	–	0.269364
		\$ 1.077456	\$ –	\$ –	\$ 1.077456
Jan. 1, 2004	Jan. 15, 2004	\$ 0.269364	\$ –	\$ –	\$ 0.269364
Apr. 1, 2004	Apr. 15, 2004	0.269364	–	–	0.269364
July 1, 2004	July 15, 2004	0.269364	–	–	0.269364
Oct. 1, 2004	Oct. 15, 2004	0.269364	–	–	0.269364
		\$ 1.077456	\$ –	\$ –	\$ 1.077456
Jan. 1, 2005	Jan. 15, 2005	\$ 0.269364	\$ –	\$ –	\$ 0.269364
Apr. 1, 2005	Apr. 15, 2005	0.269364	–	–	0.269364
July 1, 2005	July 15, 2005	0.269364	–	–	0.269364
Oct. 1, 2005	Oct. 15, 2005	0.269364	–	–	0.269364
		\$ 1.077456	\$ –	\$ –	\$ 1.077456
Jan. 1, 2006	Jan. 15, 2006	\$ 0.269364	\$ –	\$ –	\$ 0.269364

<sup>1</sup> Non-taxable represents a return of capital to unitholders, which reduces the cost base of the units.

<sup>2</sup> Excludes a distribution of \$0.2 million made to holders of special deposit warrants on March 21, 1997.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### CRITICAL ACCOUNTING POLICIES & ESTIMATES

TimberWest's accounting policies are described in [note 1](#) of the annual consolidated financial statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

TimberWest considers the following policies to be most critical in understanding the judgments that are involved in preparing the Company's consolidated financial statements and the uncertainties that could affect the Company's results of operations, financial condition and cash flows.

#### Accounting for Private Timberlands

TimberWest accounts for its private timberland assets using the sustained yield method. Under the sustained yield method, depletion is taken on the capital cost of private timberlands if harvest levels exceed growth on a sustained basis. Yield analyses are conducted at least every five years on all private timberlands to determine if a depletion charge is required.

The most recent yield analysis was completed by the Company in early 2005 and established the projected long-run sustainable harvest, or net biological growth rate, of the Company's private timberlands to be 2.5 million m<sup>3</sup> per year. This forms the basis for the Company's harvest plans. The calculation of long-run sustainable harvest implicitly assumes that the entire inventory on the Company's land base will be economic to harvest at some time, now or in the future. At any given point in time there may be inventory that is uneconomic to harvest but, due to changes in costs, technology and/or markets, over time this may change. This has proven to be the case historically. Based on the Company's most recent determination, no depletion charge is required for fiscal 2005.

The process of estimating sustained yield is complex, requiring significant decisions in the evaluation of timber stand volumes based on the development of yield curves derived from data on timber species, timber stand age and growing site indexes gathered from a physical sampling of the timberland resource base. Although every reasonable effort is made to ensure that the sustained yield determination represents the most accurate assessment possible, subjective decisions and variances in sampling data from the actual timberland resource base make this determination generally less precise than other estimates used in the preparation of the consolidated financial statements. Changes in the determination of sustained yield may result in corresponding changes in the provision for depletion of the private timberland asset in periods subsequent to periodic yield analyses, and could result in impairment of the carrying value of capital assets.

#### Accounting for Series A Subordinate Notes

Effective January 1, 2005, the Company adopted amendments to CICA Handbook Section 3860 — Financial Instruments: Disclosure and Presentation requiring obligations that may be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. The Series A Subordinate Note component of TimberWest's Stapled Units meets the criteria specified, and effective the 2005 fiscal year this component is classified as a liability on the Company's consolidated balance sheets. A detailed discussion of this issue is provided under "[Highlights & Significant Transactions — Accounting Policy Change](#)" in this management's discussion and analysis.

The Company has a unique equity instrument referred to as Stapled Units, each Stapled Unit consisting of one common share, 100 preferred shares and approximately \$8.98 face amount of Series A Subordinate Notes. These components are "stapled" together as a single unit and trade together on the Toronto Stock Exchange as Stapled Units. Components cannot be transferred except with each other as part of a Stapled Unit.

The Series A Subordinate Note component of the Company's Stapled Unit equity instrument has a "Common and/or Preferred Shares Payment Election," providing the Company with the option to satisfy its obligation to pay any interest on this component by delivering common and/or preferred shares, and with the option to pay the principal amount of the outstanding Series A Subordinate Notes by delivering common shares.

Given that the number of shares required to retire the Series A Subordinate Note component is not fixed, the Series A Subordinate Note component of the Stapled Unit is presented as a liability on the consolidated balance sheets. The Series A Subordinate Note component of Stapled Units held by unitholders had a face value of \$695.7 million as at December 31, 2005. For this same reason, interest payments on the Series A Subordinate Note component are reported, on a pre-tax basis, as an interest expense in the consolidated statements of operations. The aggregate annual amount of interest payable on Series A Subordinate Notes held by unitholders at December 31, 2005, was \$83.7 million.

#### Accounting for Employee Future Benefits

TimberWest's pension and post-retirement benefit costs are developed from actuarial valuations. Inherent in these valuations are key assumptions, including the discount rate and expected long-term rate of return on pension plan assets. Material changes in TimberWest's pension and post-retirement benefit costs may occur in the future due to a change in these assumptions, a change in the number of plan participants or a change in the level of benefits provided. A description of the Company's employee benefit plans, a summary of the assumptions used in the calculation of these assets, liabilities and expenses, and the sensitivity of key assumptions are presented in [note 14](#) of the annual consolidated financial statements.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### Accounting for Future Income Taxes

Future income tax assets and liabilities are comprised of temporary differences between the carrying amount and tax basis of assets and liabilities, as well as tax losses carried forward. The timing of the reversal of the temporary differences is estimated, and the tax rate substantively enacted for the period of reversal is applied to the temporary difference. The carrying amounts of assets and liabilities are based upon the amounts recorded in the financial statements and are therefore subject to accounting estimates that are inherent in those balances. The tax basis of assets and liabilities as well as tax losses carried forward are based upon the applicable income tax legislation, regulations and interpretations, all of which in turn are subject to interpretation. The timing of the reversal of the temporary differences is estimated based upon assumptions of expectations of future results of operations.

Assumptions underlying the composition of future income tax assets and future income tax liabilities include expectations about future results of operations and the timing of reversal of deductible temporary differences and taxable temporary differences. These assumptions also affect classification between future income tax assets and future income tax liabilities. The composition of future income tax assets and future income tax liabilities is reasonably likely to change from period to period because of the significance of these uncertainties.

If the future were to differ from management's best estimate of future results of operations and the timing of reversal of deductible temporary differences and taxable temporary differences, the Company could experience material future income tax adjustments. Additional details are provided in [note 5](#) of the annual consolidated financial statements.

## RISK MANAGEMENT

TimberWest manages principal risks of its business through established systems and procedures in two main areas: business operations, including both forest resources and facilities, and currency. The Company's principal risks can also be viewed in terms of controllable risks and non-controllable risks. Controllable risks relate primarily to the resources and assets of TimberWest and compliance with regulatory and ethical standards. Non-controllable risks result primarily from variations in product prices due to changes in market conditions, fluctuations in foreign currency exchange rates and legislative, regulatory, harvesting fee and trade policy changes made by different levels of government.

### Business Operations Risk

Revenues, net income and cash flow from TimberWest's operations are dependent on the Company's continued ability to harvest timber at adequate levels. The Company's ability to harvest timber from its timberlands in order to fund distributions to unitholders may be limited by weather conditions, timber growth cycles, market pricing, sustainable forestry standards and regulatory requirements. There can be no assurance that the Company will achieve harvest levels in the future necessary to maintain or increase revenues, net earnings and cash flows.

To minimize the potential for adverse effects arising from these risk factors, TimberWest has systems and procedures in place to monitor the utilization of resources and the protection of assets. Control mechanisms report on the efficiency and use of forestry, conversion and monetary resources. TimberWest believes that procedures in place to track and monitor changes, along with adequate insurance coverage, protect the Company's assets from undue business operations risk.

### Forest resource risk

TimberWest's private timberlands and Crown timber tenures are subject to the risks associated with standing forests. Forest fires, insect infestation and disease pose the primary risks. The Company has endeavoured to minimize these risks through prevention and early detection. Fire protection is provided through ground-based suppression crews and an aerial attack capability provided primarily by TimberWest's Martin Mars water bombers. In 2005, to further minimize the risk of fire on its own and neighbouring lands, the Company entered into a cooperative fire control agreement with the British Columbia Ministry of Forests and Range for additional fire prevention, detection, control and extinguishment services.

Over the last several decades, losses on the Company's private timberlands and Crown timber tenures due to fire, insect infestation and disease have been negligible. As is typical in the forest products industry, the Company does not maintain insurance coverage with respect to damage to the standing timber on its private timberlands. The Company does, however, maintain insurance for loss of logs due to fire and other occurrences following harvesting.

### End-market risk

The results of TimberWest's operations are, and will continue to be, affected by the cyclical nature of the forest products industry. Prices and demand for logs and manufactured wood products have been, and in the future can be expected to be, subject to cyclical fluctuations. The demand for logs and wood products is primarily affected by the level of new residential construction activity and, to a lesser extent, repair and remodelling activity and other industrial uses, which are subject to fluctuations due to changes in economic conditions, interest rates, population growth, weather conditions

## MANAGEMENT'S DISCUSSION & ANALYSIS

and other factors. Decreases in the level of residential construction activity and the emergence of non-wood, substitute products generally reduce demand for logs and wood products, resulting in lower revenues, net earnings and cash flows.

The Company's business includes the sale of logs from its private timberlands for export, which is substantially dependent on market and economic conditions in Japan, other parts of Asia and the US west coast regions. Log export revenues may be affected by, among other things, log supply in competing regions, fluctuations in exchange rates, the availability of substitute products, the level of housing starts, changes in building practices, the effect of existing federal legislation that constrains log exports from private timberlands only in British Columbia, and provincial log export policies. Historically, export grade logs have been sold at a premium over the prices that would have been received if the logs had been sold in the domestic market. British Columbia provincial legislation constrains the export of logs originating from Crown timber tenures and certain private timberland, although Crown log export levels increased in 2005 (see further discussion of this issue under "[Uncertainties — Market Access](#)" in this management's discussion and analysis).

An ancillary part of the Company's business is the sale of pulp logs. Prices for these logs are dependent on supply/demand balances for pulp fibre on the BC coast, which are in turn affected by market and economic conditions.

### Regulatory risk

Legislation in British Columbia enables the development of regulations and policies and empowers government agencies to maintain all aspects of sustainable forest management. The Forest Practices Code of British Columbia Act (Forest Practices Code), which was implemented on June 15, 1995, set comprehensive standards for forest practices on Crown timber tenures and private timberlands within TFLs, established planning procedures and introduced a range of activity-specific penalties for non-performance. In March 2003, the government of British Columbia introduced the Forestry Revitalization Plan, which provided for significant changes both to Crown forest policy, including the Forest Practices Code, and to the existing allocation of Crown timber tenures to licensees.

Since introducing its Forestry Revitalization Plan, the government has focused on initiatives to trim bureaucracy, provide increased operating flexibility and reduce costs incurred by Crown tenure holders, while preserving environmental values. The government has introduced changes to the Forest Practices Code, stumpage, cut control, appurtenancy and tenure transfers. In addition, the government has introduced the Forest and Range Practices Act — a results-based forest practices code. The Forest and Range Practices Act will over time replace the Forest Practices Code. The Company is in the process of revising its land use plans to ensure it maintains full compliance during the transition period.

As part of the Forestry Revitalization Plan, the government also proclaimed legislation which authorized a reallocation of timber

harvesting rights from Crown timber tenures. In March 2005, orders-in-council were made under the Forestry Revitalization Act to remove specific areas from TFL 47 sufficiently large enough to support a reduction of 33,207 m<sup>3</sup> and to delete 2,252 hectares from the timber licences held by the Company outside of this TFL. TimberWest was compensated for this removal in March 2005. This reduction in provincial harvesting rights is not expected to have a material effect on TimberWest.

The Private Managed Forest Land Act came into effect on November 6, 2003, replacing the Forest Land Reserve Act and the Private Land Forest Practices Regulation that, since their introduction in April 2000, had regulated managed forest land. These regulations apply to lands within the forest land reserve, including TimberWest's private lands classified as Managed Forests, and effectively cover most of TimberWest's private lands. In addition to reforestation standards, these regulations set out standards for the protection of key public environmental values including water quality, fish habitat, soil conservation and critical wildlife habitat.

On July 22, 2004, the provincial government announced regulations made under the Private Managed Forest Land Act. These regulations define the government's role relative to Managed Forests, as well as the role and operation of the new Private Managed Forest Land Council. The council is an administrative model based on a public/private agency model that has multiple roles, including responsibility for forest practices regulations, administration of the Managed Forest land base, inquiry management, forest practices audits and reporting to government and landowners. These regulations were enacted August 3, 2004.

TimberWest focuses on providing its employees with the knowledge and skills they require in order to carry out their daily tasks in full compliance with the Forest Practices Code, the Forest and Range Practices Act, the Private Managed Forest Land Act and other applicable regulations. TimberWest's employees administer agreements with contractors to ensure that they have systems in place to protect the Company's lands and meet regulatory requirements, as well as any other specified commitment made by the Company.

TimberWest is subject to numerous and increasingly stringent environmental laws and regulations of general application relating to air emissions, effluent discharges, groundwater quality, plant and wildlife protection, employee health and safety, and waste management. Changes to these laws or regulations, or the implementation of new laws or regulations, could result in additional expenses, capital expenditures, and restrictions and delays in the Company's activities. In addition, if the Company fails to comply with applicable legislation and regulations, its operations could be interrupted and it could be subject to significant liabilities, including fines and other penalties, or be required to take remedial actions, any of which could entail significant expenditure.

TimberWest employs an environmental management system to ensure the Company's operations are in compliance with these regulations. On November 29, 1999, TimberWest was awarded the [ISO 14001](#) registration for all of its operations, which indicates

## MANAGEMENT'S DISCUSSION & ANALYSIS

that TimberWest's operations have appropriate systems in place to provide substantial compliance with applicable environmental laws. TimberWest has now been in good standing with this certification program for over six years. In December of 2000, TimberWest became the first Canadian company to achieve sustainable forest management certification for its forestry operations on private land under the **American Forest & Paper Association's Sustainable Forestry Initiative (SFI®)**. The SFI® program is a rigorous system of environmental and conservation practices that includes requirements for wildlife protection, biodiversity conservation, harvesting practices and a wide range of other forest management goals. TimberWest has now been in good standing with this certification program for over five years.

### Currency Risk

TimberWest sells a substantial volume of products outside of Canada (59% of gross sales in 2005), mostly in US dollars. As such, the relative strength of the Canadian dollar versus its US counterpart has an effect on the Company's sales and earnings. The sensitivity of TimberWest's operating results to fluctuations in the value of the Canadian dollar relative to the US dollar has been discussed previously under "**Results of Operations — Sensitivities**" in this management's discussion and analysis. The relative strength of the yen and the euro also affect the Company's competitiveness in the markets in which it sells its products. The Company's approach to managing this risk has been to work on reducing costs in an effort to improve its competitiveness on a global basis.

## UNCERTAINTIES

### Business Transformation Initiative

A key component of TimberWest's business plan is the pursuit of cost reduction initiatives. As noted previously, a key element implemented by the Company effective 2005 was the transformation of its business model through a restructuring of the Company's log harvesting operations and a move to contract out all log harvesting and road building activities. The Company's business plan assumes that this initiative will continue to generate cost savings for the Company on an ongoing basis. Over time, the financial success of this initiative will be affected by market forces.

### Forest Resources

The mix of timber harvested by TimberWest changes each year. With continued harvesting, over time there is less mature timber remaining in the forest inventory, which has traditionally been the Company's higher-value fibre. This is offset by an increase in smaller diameter, mostly second-growth timber. While this shift in forest resource mix has placed downward pressure on average log sales realizations, timber harvesting costs have also declined over time as there is increased mechanization with second-growth harvesting. Historically, TimberWest has successfully offset the effects of a smaller diameter end use sort mix with lower costs and market diversification. As well, as customers adapt to the changing mix coming out of the forest, demand has improved for the smaller diameter product and pricing has reflected this improved demand. The Company will continue to pursue ongoing productivity improvements and will continue to pursue the best value for its timber resources in an effort to offset the effects of a continually changing end use sort mix.

### Market Access

The export of private land logs out of British Columbia is restricted by the federal government's surplus test, Notice 102. This test

requires that private forest landowners offer their logs for sale first in British Columbia at domestic prices, which are typically lower than export prices, and only if there is no buyer in British Columbia can a private forest landowner then sell logs outside of the country. This restriction applies only to British Columbia landowners. Private forest landowners in all other provinces, and in the US, are free to sell their logs to any customer they choose.

In 2005, TimberWest sold 1.6 million m<sup>3</sup> of logs into markets in Asia and the US west coast at an average sales realization premium of \$25 per m<sup>3</sup> over what would be realized in the domestic market. The premium earned by selling private land logs into the export market represents more than half the distributable cash generated by the Company's timberland operations. The ability to export private land logs has also played a key role in keeping employees working. Selling logs at higher international prices allows owners of private land to harvest stands that would otherwise be uneconomic.

Forcing private forest landowners to sell logs to domestic sawmills at prices lower than international prices transfers the value from the tree grower to the processors, impairs the value of private timberlands in coastal British Columbia and reduces pricing of Crown logs sold on the coast of British Columbia.

The Company has been hopeful that this matter will be resolved as part of an eventual agreement between the US and Canada on the softwood lumber issue. In 2001, TimberWest filed a statement of claim in the Federal Court of Canada challenging the validity of the private land log export restrictions that apply only to British Columbia, seeking a declaration that the provisions are of no force and effect. The Company is continuing with its legal action and anticipates the issue will go to trial in the Federal Court in the spring of 2006. There can be no assurance that the Company will succeed in this challenge. If the Company does not succeed, the restrictions imposed on the Company's ability to export logs will continue to adversely affect the Company's business.



## MANAGEMENT'S DISCUSSION & ANALYSIS

### Fibre Supply Agreements

TimberWest has entered into several fibre supply agreements with Catalyst Paper Corporation (Catalyst, formerly Norske Skog Canada Limited). These arrangements make sawlogs available to Catalyst and also provide Catalyst with a supply of wood fibre. These are long-term contracts that specify the volumes to be supplied at prevailing domestic market prices. In addition, Catalyst pays various fees to TimberWest for services provided under the agreements. These agreements are all indefinite agreements subject to termination by Catalyst only, with 12 or 24 months' notice depending on the agreement. Were any of these agreements to be terminated, depending on the market conditions at the time, there could be a positive or a negative effect on TimberWest's revenues, net earnings and cash flows.

### Labour Relations

TimberWest employs a small unionized workforce on its timberland operations and contracts out the remainder of its harvesting and road building activities. TimberWest also employs a unionized workforce in its lumber manufacturing and shipping operations. Strikes or lockouts at the Company's, its contractors' or its customers' operations could restrict the Company's ability to carry on business and could have a material adverse effect on the Company's financial condition and operating results.

At December 31, 2005, the Company had four collective agreements in place that cover all of its unionized employees.

#### The United Steelworkers of America collective agreement

The United Steelworkers of America (USWA) is the certified bargaining agent for a small number of TimberWest's hourly employees involved primarily in engineering and forestry activities at the Company's timberland operations. The current collective agreement with USWA provides for wage increases of 2% in 2006. This agreement expires on June 14, 2007.

#### The Communications, Energy & Paperworkers collective agreement

The Communications, Energy & Paperworkers (CEP) is the certified bargaining agent for TimberWest's hourly employees at the Elk Falls Lumbermill. The current collective agreement with CEP expires on May 1, 2006.

#### The International Longshore & Warehouse Union — Canada collective agreements

The International Longshore & Warehouse Union — Canada (ILWU Canada) is the certified bargaining agent for hourly employees at TimberWest's Stuart Channel Wharves operation. TimberWest is a member of the British Columbia Maritime Employers Association and the Waterfront Foreman Employers Association. Each of these associations negotiates a master agreement with ILWU Canada locals on behalf of industry members. These two collective agreements with ILWU Canada provide for wage increases of 3.2% in 2006. These agreements expire on March 31, 2007.

### Aboriginal Land Claims

Canadian courts have recognized that aboriginal peoples may possess rights at law in respect of land used or occupied by their ancestors where treaties have not been concluded to deal with these rights. These rights may vary from limited rights of use for traditional purposes to a right of aboriginal title and will depend upon, among other things, the nature and extent of the prior aboriginal use and occupation. The courts have encouraged the Canadian federal and provincial governments and aboriginal peoples to resolve rights claims through the negotiation of treaties.

Aboriginal groups in British Columbia have claimed substantial portions of land in the province over which they claim aboriginal title or in which they have a traditional interest and for which they are seeking compensation from various levels of government. A process is now in place within British Columbia to deal with aboriginal land claims. These negotiations will be ongoing for a number of years, depending on the commitment of the parties involved and the precedents set by the outcomes of the first settlement agreements.

Canadian governments have a duty to consult with and possibly accommodate aboriginal groups where their rights may be affected.

The Company cannot predict whether aboriginal land claims or other rights in British Columbia will affect its existing Crown timber tenures, its private timberlands, its ability to harvest timber from these sources in the future or its ability to renew or secure other sources in the future.

### Softwood Lumber Dispute

On May 22, 2002, the US Department of Commerce (DOC) imposed countervailing duty (CVD) of 18.8% against Canadian softwood lumber exports to the US. Also on May 22, 2002, the DOC imposed anti-dumping duty (ADD), which for TimberWest were set at 8.4%.

The effect of these US trade measures has affected the Company's domestic log customers and will continue to have an effect on softwood lumber producers in BC, including the Company's ability to export softwood lumber from the Elk Falls Lumbermill.

The Canadian federal and provincial governments have launched challenges of these tariffs under the North American Free Trade Agreement (NAFTA) and with the World Trade Organization (WTO).

The year 2005 was one of steady technical improvement for Canadian interests in the softwood lumber file. In early June 2005, the DOC announced preliminary results for its second administrative review. Under this review, the CVD rate dropped to 8.18%, and the ADD rate fell to 2.44%.

In early August 2005, an Extraordinary Challenge Committee supported an earlier NAFTA panel ruling that the US had not proven a threat to US lumber producers from Canadian lumber imports, the claim that underpinned the entire US case for duties.

In late August 2005, the WTO rejected Canada's challenge to a ruling by the US International Trade Commission that US lumber producers are threatened with injury by imports of softwood

## MANAGEMENT'S DISCUSSION & ANALYSIS

lumber from Canada. Canada plans to appeal this ruling before the Court of International Trade.

In September 2005, the US lumber lobby filed a lawsuit challenging the constitutionality of a dispute settlement known as "Chapter 19 dispute mechanism" which ruled in Canada's favour. The challenge could take years to resolve and pits the Coalition for Fair Lumber Imports against the US government as well as the Canadian government.

In October 2005, the NAFTA panel ordered the US DOC to use a new profit margin in calculating the countervailing duty for Quebec, Ontario, Manitoba and Saskatchewan. The new rate, which was applied in late October 2005, brings the national countervailing duty assessment to less than 1%, which is considered *de minimis*, effectively cancelling the US subsidy issue.

In December 2005, US DOC issued the final results of a second administrative review. In the final results the CVD was reduced to 8.70% and the ADD was reduced to 2.11% for a total deposit rate of 10.81%. TimberWest's combined CVD/ADD rate is 10.80%.

Lumber sales by TimberWest into the US were not significant during 2005. Approximately \$1.5 million of combined CVD and ADD on softwood lumber shipments to the US have been reflected in the Company's financial results as an element of cost of sales for the year ended December 31, 2005. Since the softwood lumber dispute began in 2002, the Company has paid combined CVD and ADD of \$3.8 million. Cash payments for both the CVD and ADD have been made at the assessed rates.

## Legal Issues

### Notice 102

TimberWest filed a statement of claim in the Federal Court of Canada July 31, 2001, calling on the federal government to repeal its discriminatory private land log export restriction that imposes, only in BC, a "surplus test" on private forest landowners (see further discussion of this issue under "[Uncertainties — Market Access](#)" in this management's discussion and analysis). The federal government filed a statement of defence in September 2001. The government also filed a motion to strike the statement of claim in October 2001. A Federal Court order dated June 12, 2002, supported TimberWest, and the action is proceeding, with examinations for discovery and associated undertakings completed. TimberWest had hoped this issue would be resolved as part of the softwood lumber negotiations (see further discussion of this issue under "[Uncertainties — Softwood Lumber Dispute](#)" in this management's discussion and analysis). However, if a negotiated settlement is not reached in the near term, the issue will go to trial in the Federal Court in the spring of 2006.

The Company is subject to additional legal proceedings and claims that arise in the ordinary course of its business. Although there can be no assurance as to the disposition of these matters and the proceedings, it is the opinion of the Company's management, based upon the information available at this time, that the expected outcome of these matters, individually or in aggregate, will not have a material adverse effect on the results of operations and financial condition of the Company.

## DISCLOSURE CONTROLS & PROCEDURES

Based on current securities legislation in Canada, the President and Chief Executive Officer and the Vice-President, Finance, and Chief Financial Officer of the Company are required to certify that they have evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2005.

An evaluation was performed under the supervision and with the participation of the Company's management, including the

President and Chief Executive Officer and the Vice-President, Finance, and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of December 31, 2005. Based on that evaluation, the Company's management concluded that the Company's disclosure controls and procedures were effective as of December 31, 2005.

## MANAGEMENT'S DISCUSSION & ANALYSIS

### OUTLOOK

For 2006, TimberWest anticipates housing markets in both the US and Japan to run at levels consistent with those for 2005 through the first part of the year, with a modest reduction in the US housing market expected in the last half of the year but a stable Japanese housing market throughout the year. Other Asian log markets are expected to be stable in the year ahead.

In the US, 2006 has begun with strong demand for logs and strong prices for all of the Company's products. In addition to the robust housing market, there is also a seasonal shortage of logs as a result of weather-related harvesting curtailments in the US Pacific Northwest. The Company expects these conditions to continue, which will support strong demand and pricing levels in the near term. However, the Canadian dollar is expected to remain strong throughout the year, and as a result TimberWest's net sales realizations from this market are expected to be comparable with the sales realizations achieved in the second half of 2005.

In the Japanese market, demand for logs is expected to be stable, with the possibility of some improvement in pricing. Even with the weak yen and the strong Canadian dollar, in the near term the Company expects that net sales realizations from this market will be slightly ahead of where they were in the last half of 2005.

The Company is increasingly optimistic about its prospects in other Asian markets in the upcoming year and anticipates shipping more volume to these markets than it has in the past. Sales realizations in non-Japanese Asian markets are superior to those available in the domestic market.

TimberWest expects 2006 to be another weak year in the domestic log market, with the lumber industry on the BC coast continuing to get smaller and restructure. While this is a necessary prelude to the revitalization process on the coast, the effect will be to keep log prices depressed for most end use sorts in 2006.

On the cost side, the Company expects 2006 costs to be comparable to those for 2005 in our timberland business. Production costs are typically lower during the first half of the year as harvesting is generally at lower elevations and consequently use lower-cost harvest systems. Logging costs for the first half of 2006 are expected to be comparable to those of the first half of 2005.

Despite good export markets and a continued focus on cost containment, the strength of the Canadian dollar — which forecasters suggest will persist throughout 2006 — means that TimberWest is unlikely to generate its distributable cash requirements from timberland and sawmill operations.

However, real estate markets on Vancouver Island remain solid and as a result the Company expects to generate sufficient cash flow from real estate sales to make up for the shortfall from timberland operations.

TimberWest expects to generate sufficient distributable cash to meet its distribution requirements for 2006 and to maintain its strong financial condition.

*The statements that are not historical facts contained in this report are forward-looking statements that involve risks and uncertainties. TimberWest's actual results could differ materially from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, general economic conditions, variations in TimberWest's product prices and changes in commodity prices generally, changes in market conditions, actions of competitors, interest rate and foreign currency fluctuations, regulatory, harvesting fee and trade policy changes and other actions by governmental authorities, changes in the Company's ability to implement business strategies and pursue business opportunities, labour relations, weather conditions, forest fires, insect infestation, disease and other natural phenomena, and other risks and uncertainties described above.*



## MANAGEMENT'S RESPONSIBILITY

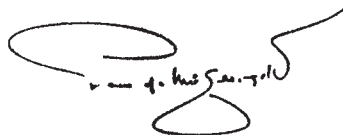
To the Unitholders of TimberWest Forest Corp.:

The accompanying consolidated financial statements of TimberWest Forest Corp. and all information in this annual report are the responsibility of management and have been reviewed and approved by the Company's Board of Directors. These consolidated financial statements and related notes have been prepared by management in conformity with accounting principles generally accepted in Canada and necessarily include amounts based on management's informed judgments and estimates. Financial information included elsewhere in this annual report is consistent with that contained in the consolidated financial statements.

To assist management in fulfilling its responsibilities, a system of internal accounting controls has been established to provide reasonable assurance that the consolidated financial statements are accurate and reliable and that assets are safeguarded. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2005.

KPMG LLP, Chartered Accountants, appointed by the unitholders, have audited the consolidated financial statements and conducted a review of internal accounting policies and procedures to the extent required by generally accepted auditing standards in Canada and performed such tests as they deemed necessary to enable them to express an opinion on the consolidated financial statements.

The Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls, and is ultimately responsible for reviewing and approving the consolidated financial statements and the management's discussion and analysis. The Audit Committee is composed of four independent directors who are not employees of the Company. The Audit Committee meets regularly with management, KPMG LLP and the internal auditors to review their activities and to discuss internal control, accounting, auditing and financial matters. The Audit Committee recommends the appointment of the external auditors. The Audit Committee also meets quarterly to review interim and annual consolidated financial statements and related materials and reports its findings to the Board of Directors for its consideration in approving the consolidated interim and annual financial statements for public dissemination.



Paul J. McElligott  
President &  
Chief Executive Officer



Beverlee F. Park  
Vice-President, Finance, &  
Chief Financial Officer

TimberWest Forest Corp.  
Vancouver, Canada  
January 20, 2006

## AUDITORS' REPORT

To the Unitholders of TimberWest Forest Corp.:

We have audited the consolidated balance sheets of TimberWest Forest Corp. as at December 31, 2005 and 2004, and the consolidated statements of operations, cash flows and unitholders' equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants  
Vancouver, Canada  
January 20, 2006

## CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

### CONSOLIDATED STATEMENTS OF OPERATIONS

<i>(in millions of dollars, except per common share amounts)</i>	<b>2005</b>	2004 <i>(restated — note 2)</i>
Sales	<b>\$ 458.2</b>	\$ 477.0
Operating costs and expenses:		
Cost of sales	<b>365.1</b>	358.0
Selling, administrative and other	<b>14.2</b>	14.5
Depreciation, depletion and amortization	<b>8.8</b>	10.1
	<b>388.1</b>	382.6
Operating earnings	<b>70.1</b>	94.4
Interest expense:		
Series A Subordinate Notes owned by unitholders	<b>83.3</b>	82.5
Long-term debt	<b>14.8</b>	14.3
Short-term debt	<b>1.1</b>	1.9
	<b>99.2</b>	98.7
Amortization of deferred financing costs	<b>0.7</b>	1.1
Other (income) expense, net	<b>(8.0)</b>	(8.2)
Termination of fibre supply agreement <i>(note 4)</i>	<b>15.0</b>	—
	<b>106.9</b>	91.6
Earnings (loss) before income taxes and extraordinary item	<b>(36.8)</b>	2.8
Income tax recovery <i>(note 5)</i>	<b>(41.6)</b>	(11.9)
Earnings before extraordinary item	<b>4.8</b>	14.7
Extraordinary item — expropriation settlement proceeds, net of applicable income taxes <i>(note 6)</i>	<b>—</b>	9.0
Net earnings	<b>\$ 4.8</b>	\$ 23.7
Basic and diluted earnings per common share before extraordinary item <i>(note 7)</i>	<b>\$ 0.06</b>	\$ 0.19
Extraordinary item, net of applicable income taxes, per common share	<b>—</b>	0.12
Basic and diluted net earnings per common share <i>(note 7)</i>	<b>\$ 0.06</b>	\$ 0.31

### CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>(in millions of dollars)</i>	<b>2005</b>	2004
Retained earnings, beginning of period	<b>\$ 28.4</b>	\$ 4.7
Net earnings for the period	<b>4.8</b>	23.7
Retained earnings, end of period	<b>\$ 33.2</b>	\$ 28.4

See accompanying notes to consolidated financial statements.



# CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

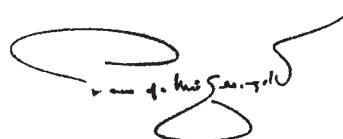
## CONSOLIDATED BALANCE SHEETS

<i>(in millions of dollars)</i>	2005	2004 <i>(restated — note 2)</i>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 3.0	\$ 1.6
Accounts receivable	23.9	14.7
Inventories <i>(note 8)</i>	48.2	62.2
Prepaid expenses and other current assets	11.2	5.7
Future income taxes <i>(note 5)</i>	2.5	3.8
	88.8	88.0
Property, plant and equipment, net <i>(note 9)</i>	1,318.4	1,334.3
Other assets <i>(note 10)</i>	11.9	12.2
	\$ 1,419.1	\$ 1,434.5
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Revolving credit facilities <i>(note 11)</i>	\$ —	\$ 22.0
Accounts payable and accrued liabilities	30.1	35.5
Distribution payable	20.9	20.7
	51.0	78.2
Revolving credit facilities <i>(note 11)</i>	37.0	—
Debentures <i>(note 12)</i>	195.0	195.0
Long-term silviculture liability <i>(note 13)</i>	3.2	2.8
Non-pension post-retirement benefits <i>(note 14)</i>	28.6	27.1
Future income taxes <i>(note 5)</i>	184.9	224.3
	499.7	527.4
Series A Subordinate Notes owned by unitholders <i>(notes 2 and 15(b)(i))</i>	695.7	690.5
	1,195.4	1,217.9
Unitholders' equity:		
Share capital, consisting of preferred shares and common shares <i>(note 15(b))</i>	189.8	187.8
Contributed surplus	0.7	0.4
Retained earnings	33.2	28.4
	223.7	216.6
	\$ 1,419.1	\$ 1,434.5

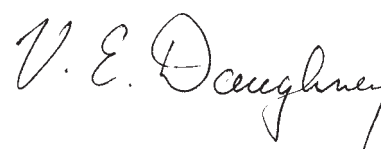
### Commitments and contingencies *(note 16)*

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



Paul J. McElligott  
Director



V. Edward Daughney  
Director

# CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

## CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(in millions of dollars)</i>	2005	2004
		<i>(restated — note 2)</i>
<b>Cash provided by (used in):</b>		
<b>Operating activities:</b>		
Net earnings	\$ 4.8	\$ 23.7
Items not involving cash:		
Depreciation, depletion and amortization	9.5	11.2
Gain on sale of property, plant and equipment	(13.0)	(12.4)
Future income tax recovery	(38.1)	(7.4)
Other non-cash items	2.3	2.3
	(34.5)	17.4
Changes in non-cash working capital:		
Accounts receivable	(9.2)	(0.3)
Inventories	14.0	(16.5)
Prepaid expenses and other current assets	(6.7)	0.4
Accounts payable and accrued liabilities	(5.4)	6.2
Distribution payable	0.2	0.2
	(41.6)	7.4
<b>Financing activities:</b>		
Issuance of Stapled Units on exercise of options:		
Series A Subordinate Notes	5.2	5.9
Share capital	1.9	1.8
	7.1	7.7
Revolving credit facilities	15.0	(38.0)
	22.1	(30.3)
<b>Investing activities:</b>		
Proceeds from sale of property, plant and equipment	42.8	33.3
Additions to property, plant and equipment	(22.6)	(8.5)
Other assets	0.7	(0.3)
	20.9	24.5
Increase in cash	1.4	1.6
Cash and cash equivalents, beginning of year	1.6	—
Cash and cash equivalents, end of year	\$ 3.0	\$ 1.6
<b>Supplementary information:</b>		
Interest on Series A Subordinate Notes paid to unitholders	\$ 83.1	\$ 82.3
Other interest paid	\$ 16.0	\$ 16.0
Income taxes paid	\$ 0.6	\$ 0.8

See accompanying notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements are expressed in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

#### (a) Basis of consolidation:

The consolidated financial statements include the accounts of TimberWest Forest Corp. and its subsidiaries. All significant intercompany transactions and balances have been eliminated. In these financial statements, the term “Company” is used to mean TimberWest Forest Corp. and, where the context of the narrative permits or requires, its subsidiaries.

#### (b) Use of estimates:

The consolidated financial statements have been prepared in conformity with GAAP, which require management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the year, the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. On an ongoing basis, management reviews its estimates, including those related to litigation, environmental liabilities, inventory valuation, useful lives, rates for depreciation, depletion and amortization, impairment of long-lived assets, silviculture liabilities, income tax assets and liabilities, stock-based compensation, pension and post-retirement obligations, and estimates of fair values of financial instruments, based on currently available information. Actual results could differ from those estimates.

#### (c) Foreign currency:

Revenue and expense items denominated in foreign currencies are translated at rates of exchange prevailing during the year. Monetary assets and liabilities denominated in foreign currencies are translated at the year-end exchange rates. Gains or losses on translation are reflected in net earnings for the period.

#### (d) Revenue recognition:

The Company recognizes its revenues when the significant risks and rewards of ownership are transferred, which is generally at time of shipment, but taking into account the FOB point.

#### (e) Shipping and handling costs:

Amounts charged to customers related to shipping and handling are included in sales, and related shipping and handling costs are recorded in cost of sales.

#### (f) Cash and cash equivalents:

Cash and cash equivalents include cash and short-term investments with original maturities of less than three months and are presented at cost.

#### (g) Accounts receivable:

Accounts receivable are recorded at cost net of a provision for doubtful accounts that is based on expected collectibility.

#### (h) Inventories:

Inventories other than supplies are recorded at the lower of average cost and net realizable value. Supplies are recorded at the lower of cost and replacement cost.

#### (i) Deferred debt issue costs:

Debt issue costs related to credit facilities and debentures are deferred and amortized over the respective terms to maturity.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (j) Property, plant and equipment:

Property, plant and equipment are capitalized at cost. Plant and equipment are depreciated on a straight-line basis at rates that reflect estimates of the economic lives of the assets based on the following annual rates of depreciation:

Assets	Rate
Buildings	2.5% – 5%
Machinery and equipment	5% – 25%
Other	3% – 20%

Crown timber tenures are depleted in a systematic manner based on the utilization of the timber resources. Logging roads are amortized on a straight-line basis over 12 years, which approximates the utilization of the related timber resources.

Private timberlands are accounted for using the sustained yield method. Depletion will be taken on the capital cost of the private timberlands if harvest levels exceed growth on a sustained basis. Yield analyses are conducted at least every five years on all private timberlands to determine if a depletion charge is required.

Silviculture costs relating to the reforestation of private timberlands, including site preparation and planting, are expensed as incurred.

### (k) Impairment of long-lived assets:

Long-lived assets are tested for impairment in value whenever events or changes in circumstances indicate their carrying amount may not be recoverable. An impairment loss is recognized if, at the date it is tested for impairment, the carrying amount of the property, plant and equipment exceeds the sum of the undiscounted cash flows expected to result from their use and/or eventual disposition. The impairment loss is measured as the amount by which the carrying amount of the property, plant and equipment exceeds its fair value.

### (l) Silviculture costs:

British Columbia legislation requires the holders of Crown timber harvesting licences to assume the cost of reforestation on these licences. Accordingly, the Company estimates the cost of reforestation of these licence areas as the timber is harvested and determines the fair value of this liability with reference to the present value of estimated future cash flows. The fair value of this liability is subject to re-measurement at each reporting period. The portion of this liability representing expenditures projected to take place within the next year is classified as a current liability and the remainder is classified as a long-term liability.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (m) Employee benefit plans:

The Company has established employee benefit plans as described in [note 14](#). The Company accrues its obligations under these plans and the related costs, net of plan assets. The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health-care costs. For the purpose of calculating the expected return of plan assets, those assets are valued at fair value. Past service costs from plan amendments are amortized over the average remaining life expectancy of inactive employees. For the Company's pension plans, the excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining life expectancy of inactive employees. For the Company's non-pension post-retirement plans, actuarial gains (losses) are amortized over the average remaining service period of active employees. Defined contribution plan accounting is applied to a multi-employer defined benefit plan.

#### (n) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future 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. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. Current income taxes are recognized for the estimated income taxes payable for the current year.

#### (o) Stock-based compensation plans:

The Company has established stock-based compensation plans for eligible directors, officers and employees as described in [note 17](#). The Company's stock-based compensation plans are accounted for using the fair value-based method, and accordingly compensation expense is recognized for awards made under these plans. Compensation expense is computed when Stapled Unit options are awarded to plan participants and when payments are made in connection with the Distribution Equivalent Plan and is deferred and amortized over the vesting period of the underlying options. Any consideration paid by plan participants on the exercise of Stapled Unit options is credited to unitholders' equity. A credit to contributed surplus is recorded for the fair value of Stapled Unit option awards granted and for forfeited distribution equivalent awards.

#### (p) Earnings per share:

Earnings per share amounts are determined using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method for determining the dilutive effect of Stapled Unit options and other dilutive instruments, when applicable. Under this method, only "in the money" dilutive instruments are considered in the diluted calculations.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 2. CHANGE IN ACCOUNTING POLICY

Effective January 1, 2005, the Company adopted amendments to CICA Handbook Section 3860 — Financial Instruments: Disclosure and Presentation. Section 3860 establishes standards for the balance sheet presentation of financial instruments or their components as liabilities or equity. The amendment to Section 3860 requires obligations that may be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. This amendment is effective for the Company's 2005 fiscal year and has been adopted on a retroactive basis, with restatement of amounts in the comparative financial statements.

The Company's Stapled Units are a unique equity instrument, consisting of one common share, 100 preferred shares and approximately \$8.98 face amount of Series A Subordinate Notes. These components are "stapled" together as a single unit and trade together on the Toronto Stock Exchange as Stapled Units. Components cannot be transferred except with each other as part of a Stapled Unit. The Company has previously classified all components of the Stapled Unit as equity on its balance sheet, as the Subordinate Notes and the interest thereon have a "Common and/or Preferred Shares Payment Election." This election provides the Company with the option to satisfy its obligation to pay any interest on the Subordinate Notes by delivering common and/or preferred shares, and with the option to pay the principal amount of the outstanding Subordinate Notes by delivering common shares.

Given that the number of shares required to retire the Subordinate Note component is not fixed, the Series A Subordinate Note component of the Stapled Unit is no longer classified as equity and is now presented as a liability on the Company's consolidated balance sheets. As at December 31, 2005, the Series A Subordinate Note component liability was \$695.7 million (December 31, 2004 — \$690.5 million).

Further, holders of the Company's Stapled Units are entitled to annual interest payments on the Subordinate Note component of approximately \$1.08 per Stapled Unit. For the same reason that the Subordinate Note component was previously classified as equity on the Company's consolidated financial statements, interest payments on Stapled Units have previously been recorded as a distribution to unitholders and charged directly to retained earnings, on an after-tax basis, similar to dividends on common shares. The amendment to Section 3860 requires that the interest on Series A Subordinate Notes paid to unitholders be reported, on a pre-tax basis, as interest expense in the statement of operations. This revision also requires the tax benefit provided by the distributions to be reported as a component of the income tax provision in the statement of operations.

For the year ended December 31, 2005, interest on the Series A Subordinate Notes of \$83.3 million has been reported as an interest expense in the consolidated statements of operations, whereas in 2004 the interest amount of \$82.5 million and the income tax benefit thereon of \$29.3 million had previously been reported in retained earnings.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 3. BUSINESS TRANSFORMATION

The Company completed the final phase of its business transformation initiative early in 2005, with the buyout of leases on Company-operated logging equipment for \$21.0 million, and the subsequent sale of this leased equipment and other Company-owned logging equipment to long-term contractors for proceeds of approximately \$25.1 million. Other income for the year ended December 31, 2005, includes a gain on disposal of the logging equipment of approximately \$4.0 million.

During the second quarter of 2005, the Company realigned the roles and responsibilities of personnel under the new business model and eliminated additional salaried positions in the timberland and corporate overhead components of its business. Operating earnings for the year ended December 31, 2005, reflect an expense of \$2.0 million in cost of sales relating to this restructuring.

During the second quarter of 2004, the Company completed the sale of its southern Vancouver Island public land operations, referred to as TFL 46. The sale price for these assets was \$17.9 million. Other income for the year ended December 31, 2004, included the gain on the sale of these operations.

### 4. TERMINATION OF FIBRE SUPPLY AGREEMENT

In the third quarter of 2005, the Company reached an agreement to terminate a fibre supply agreement with a customer for payment of \$15.0 million. The fibre supply agreement was originally entered into in 1997 and required the Company to offer the customer, in perpetuity, an annual volume of 330,000 m<sup>3</sup> of sawlogs at domestic market prices.

### 5. INCOME TAXES

	2005	2004 (restated — note 2)
Current income tax expense (recovery):		
Large corporation tax	\$ 0.6	\$ 0.5
Federal income tax recovery	(4.1)	—
	(3.5)	0.5
Future income tax recovery	(38.1)	(12.4)
	\$ (41.6)	\$ (11.9)

During 2005, the Company implemented a number of tax planning strategies with respect to the availability of non-capital losses. As a result of these activities, the Company recorded a \$16.1 million future income tax recovery.

The provision for future income taxes for the year ended December 31, 2004, includes a \$5.0 million recovery to recognize the benefit of losses utilized to offset the income tax expense that would otherwise be applicable to expropriation settlement proceeds of \$14.0 million received during that year (see note 6).

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

## 5. INCOME TAXES (continued)

The Company's effective income tax rate differs from the Canadian statutory income tax rate. The principal factors causing the difference are as follows:

	2005	2004 (restated — note 2)
Earnings (loss) before income taxes and extraordinary item	\$ (36.8)	\$ 2.8
Income tax (recovery) expense at statutory rates (2005 — 34.9%; 2004 — 35.6%)	\$ (12.8)	\$ 1.1
Large corporation tax	0.6	0.5
Refund received on prior year tax assessment appeal	(4.1)	—
Adjustment to net future tax liabilities for changes in tax rates	(9.3)	—
Non-deductible expenses	1.5	0.1
Tax losses not previously recognized utilized	(11.5)	(10.2)
Permanent difference tax effected at capital gains rate	(3.2)	(2.7)
Change in prior year estimated tax values	(2.8)	0.3
Other	—	(1.0)
Income tax recovery	\$ (41.6)	\$ (11.9)

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2005 and 2004, are presented below:

	2005	2004
<b>Net future tax assets:</b>		
Current silviculture liability	\$ 0.6	\$ 0.6
Accruals for financial reporting purposes not deductible for tax purposes	1.9	3.2
Net future tax assets, current	\$ 2.5	\$ 3.8
<b>Net future tax liabilities:</b>		
Private timberlands	\$ (196.4)	\$ (220.2)
Other property, plant and equipment	(0.7)	(13.0)
Other assets	1.4	(1.7)
Non-pension post-retirement benefits	9.7	9.6
Long-term silviculture liability	1.1	1.0
Capital loss carryforwards	25.1	26.2
Non-capital loss carryforwards	37.0	39.1
Total gross future tax liabilities	(122.8)	(159.0)
Valuation allowance	(62.1)	(65.3)
Net future tax liabilities, non-current	\$ (184.9)	\$ (224.3)



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

## 6. EXTRAORDINARY ITEM — EXPROPRIATION SETTLEMENT PROCEEDS

In 2004 the Company received \$14.0 million from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley and Hitchie Creek areas for park creation purposes under the Park Amendment Act, 1995 (British Columbia). The \$14.0 million proceeds from this settlement have been accounted for as an extraordinary item in the consolidated statements of earnings for 2004, net of \$5.0 million in income taxes affected at statutory tax rates. As the Company had non-capital losses carried forward from previous taxation years, income taxes were not paid on the proceeds from this settlement. The future income tax recovery before the extraordinary item for the year ended December 31, 2004, has been increased by \$5.0 million to recognize the benefit of the losses utilized and fully offsets the tax expense charged to the extraordinary item.

## 7. EARNINGS PER SHARE

	2005	2004
Earnings before extraordinary item	\$ 4.8	\$ 14.7
Extraordinary item, net of income taxes	—	9.0
Net earnings	\$ 4.8	\$ 23.7
Basic weighted average number of common shares	77,207,309	76,523,531
Incremental common shares from potential exercise of options	108,130	105,755
Diluted weighted average number of common shares	77,315,439	76,629,286
Basic and diluted earnings before extraordinary item per common share	\$ 0.06	\$ 0.19
Extraordinary item, net of income taxes, per common share	—	0.12
Basic and diluted net earnings per common share	\$ 0.06	\$ 0.31

## 8. INVENTORIES

	2005	2004
Logs	\$ 39.3	\$ 54.1
Lumber	7.5	6.8
Supplies	1.4	1.3
	\$ 48.2	\$ 62.2

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

## 9. PROPERTY, PLANT AND EQUIPMENT

2005	Cost	Accumulated depreciation	Net book value
Logging buildings and equipment	\$ 19.9	\$ 9.7	\$ 10.2
Lumbermill and other equipment and facilities	50.2	23.1	27.1
Land	30.1	—	30.1
	\$ 100.2	\$ 32.8	67.4
Timberlands (including \$1,214.0 million of private timberlands) and logging roads (net of depletion and amortization)			1,251.0
			\$ 1,318.4
2004	Cost	Accumulated depreciation	Net book value
Logging buildings and equipment	\$ 29.8	\$ 17.4	\$ 12.4
Lumbermill and other equipment and facilities	50.2	19.7	30.5
Land	35.6	—	35.6
	\$ 115.6	\$ 37.1	78.5
Timberlands (including \$1,214.0 million of private timberlands) and logging roads (net of depletion and amortization)			1,255.8
			\$ 1,334.3

The \$1,214.0 million (2004 — \$1,214.0 million) carrying value for private timberlands includes a valuation increase adjustment of \$389.8 million (2004 — \$389.8 million) recorded in the year ended December 31, 2000, resulting from the adoption of Section 3465 — Income Taxes of the CICA Handbook, which was mandatory for fiscal years ending on or after January 1, 2000.

## 10. OTHER ASSETS

	2005	2004
Prepaid pension benefits (note 14)	\$ 8.3	7.4
Deferred debt issue costs	1.4	1.7
Receivable on sale of property, plant and equipment	0.5	0.5
Other	1.7	2.6
	\$ 11.9	12.2

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 11. CREDIT FACILITIES

As at December 31, 2005, the Company's credit facilities were comprised of:

**(a) \$10.0 million unsecured demand operating facility:**

The Company has an unsecured demand operating facility of \$10.0 million. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based and US base rate-based loans. This facility has been underwritten by a Canadian chartered bank and is due on demand. As at December 31, 2005, the Company had no borrowings on this facility. The average effective interest rate on this facility for the period it was outstanding during 2005 was 4.63%.

**(b) \$16.3 million unsecured 364-day demand bank guarantee facility:**

The Company has an unsecured 364-day demand bank guarantee facility of \$16.3 million. This facility has been underwritten by a Canadian chartered bank and is due on June 30, 2006, and is subject to annual review and approval. As at December 31, 2005, the Company had issued letters of credit or guarantee in the amount of \$15.9 million on this facility. The guarantee fee on this facility for the period it was outstanding during 2005 was 0.75%.

**(c) \$65.0 million unsecured long-term revolving facility:**

The Company has an unsecured revolving facility of \$65.0 million. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based loans, bankers' acceptances, LIBOR loans and letters of credit or guarantee. This facility has been underwritten by a Canadian chartered bank and is due on July 7, 2010. As at December 31, 2005, the Company had borrowings of \$7.0 million on this facility. The average effective interest rate on this facility for the period it was outstanding during 2005 was 3.67%.

**(d) \$100.0 million unsecured long-term revolving facility:**

The Company has a second unsecured revolving facility of \$100.0 million. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based loans, US base rate-based loans, bankers' acceptances, LIBOR loans and letters of credit or guarantee. This facility has been underwritten by a syndicate of Canadian chartered banks and is due on July 27, 2010. As at December 31, 2005, the Company had borrowings of \$30.0 million on this facility. The average effective interest rate on this facility for the period it was outstanding during 2005 was 3.61%.

### 12. DEBENTURES

The Company's \$195.0 million aggregate principal amount of debentures bear interest at 7% per annum, mature on October 1, 2007, are unsecured and unsubordinated, and rank senior in priority to the Series A Subordinate Notes held by unitholders and equally with indebtedness of the Company under its credit facilities.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 13. SILVICULTURE LIABILITY

The Company's silviculture liability and expense are as follows:

	2005	2004
Silviculture liability, beginning of year	\$ 4.5	\$ 3.9
Expense for the year	2.2	2.4
Less: paid during the year	(1.7)	(1.4)
Less: transfer of liability on sale of Crown tenure	—	(0.4)
Silviculture liability, end of year	\$ 5.0	\$ 4.5
Current (included in accounts payable and accrued liabilities)	\$ 1.8	\$ 1.7
Long-term	3.2	2.8
	\$ 5.0	\$ 4.5

The total undiscounted amount of the estimated cash flows required to settle the Company's silviculture liability at December 31, 2005, was \$6.2 million (2004 — \$5.8 million), with payments spread over 15 years. The estimated cash flows have been adjusted for inflation and discounted using credit-adjusted risk-free rates ranging from 6.8% to 8.0%.

### 14. EMPLOYEE BENEFITS

The Company, through its subsidiaries, maintains pension plans that include defined benefit (DB Plans) and defined contribution (DC Plan) segments available to all salaried employees and to hourly employees not covered by union pension plans. Employees are no longer eligible to join the DB Plans. Most non-union active employees are currently participating in the DC Plan.

Unionized employees of the Company's subsidiaries are members of a multi-employer defined benefit pension plan providing both pension and other retirement benefits. The Company contributes a pre-set amount per hour worked by employees to this plan (aggregating \$1.4 million during the year ended December 31, 2005 [2004 — \$3.2 million]), and accounts for these payments as a defined contribution plan as the Company has no further obligations relating to the pension benefits of its unionized employees. Contributions to this plan are not included in the Company's pension benefit plans described below.

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the Company's pension plans for funding purposes was as of December 31, 2003. This valuation identified a going-concern deficit of \$3.9 million and a solvency deficit of \$5.1 million for the DB Plans. Based on the results of the valuation, commencing in 2004, the Company is required to fund annual current service costs of approximately \$1.4 million, including required contributions under the DB Plans and the DC Plan. In addition, the Company is required to fund the deficit position in the DB Plans with annual costs of approximately \$1.2 million. The Company's next required valuation will be as of December 31, 2006.

For the year ended December 31, 2005, the Company recorded an expense of \$2.5 million for pension benefit costs (2004 — \$3.2 million) and made cash payments of \$3.3 million to fund current and future service costs (2004 — \$2.8 million), including \$0.4 million (2004 — \$0.2 million) for required contributions under the DB Plans, \$1.2 million (2004 — \$0.9 million) to fund the deficit in the DB Plans, \$0.8 million (2004 — \$0.8 million) for benefit payments relating to unfunded DB Plans, and \$0.9 million (2004 — \$0.9 million) for required contributions under the DC Plan.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

## 14. EMPLOYEE BENEFITS (continued)

The Company also provides non-pension benefits consisting of group life insurance and medical benefits to eligible retired employees, which the Company funds on an as-incurred basis. For the year ended December 31, 2005, the Company recorded an expense of \$3.6 million for non-pension benefit costs (2004 — \$3.5 million) and made cash payments of \$2.0 million to fund current benefit costs (2004 — \$1.8 million).

Information about the Company's defined benefit plans other than the multi-employer defined benefit plan, in aggregate, is as follows:

	Pension benefit plans		Post-retirement benefit plans	
	2005	2004	2005	2004
<b>Change in fair value of plan assets during the year:</b>				
Fair value of plan assets, beginning of year	\$ 90.8	\$ 86.2	\$ —	\$ —
Actual return on plan assets	13.1	12.3	—	—
Employer contributions	2.5	2.2	2.0	1.8
Benefits paid	(9.0)	(9.9)	(2.0)	(1.8)
Fair value of plan assets, end of year	\$ 97.4	\$ 90.8	\$ —	\$ —
<b>Change in accrued benefit obligation during the year:</b>				
Accrued benefit obligation, beginning of year	\$ 99.9	\$ 103.8	\$ 37.5	\$ 39.9
Current service cost	0.3	0.4	0.8	0.7
Interest cost	5.7	5.9	2.2	2.2
Benefits paid	(9.0)	(9.9)	(2.0)	(1.8)
Net actuarial (gain) loss	9.5	(0.3)	4.7	(3.5)
Accrued benefit obligation, end of year	\$ 106.4	\$ 99.9	\$ 43.2	\$ 37.5
<b>Reconciliation of funded status:</b>				
Excess of accrued benefit obligation over plan assets	\$ (9.0)	\$ (9.1)	\$ (43.2)	\$ (37.5)
Unamortized net actuarial loss	17.3	15.2	14.6	10.4
Unamortized past service costs	—	1.3	—	—
Net asset (accrued liability) at December 31	\$ 8.3	\$ 7.4	\$ (28.6)	\$ (27.1)
<b>Amounts recognized in the Consolidated Balance Sheets consist of:</b>				
Other assets	\$ 8.3	\$ 7.4	\$ —	\$ —
Non-pension post-retirement benefits	—	—	(28.6)	(27.1)
Net amount recognized at December 31	\$ 8.3	\$ 7.4	\$ (28.6)	\$ (27.1)

The assets of the pension plans are held by independent trustees and are accounted for separately in the Company's pension funds. Based on the fair value of assets held at December 31, 2005, the plan assets were comprised of 10% invested in income trusts, 25% in equities and 65% in bonds. Equity securities held in the plans do not include any of the Company's Stapled Units.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

## 14. EMPLOYEE BENEFITS (continued)

The accrued benefit obligations in excess of fair value of plan assets at year-end with respect to pension benefit plans that are not fully funded are as follows:

	Pension benefit plans		Post-retirement benefit plans	
	2005	2004	2005	2004
Fair value of plan assets	\$ —	\$ —	\$ —	\$ —
Accrued benefit obligation	(12.0)	(10.6)	(43.2)	(37.5)
Plan deficit	\$ (12.0)	\$ (10.6)	\$ (43.2)	\$ (37.5)

The Company's net benefit plan expense recognized in the year is as follows:

	Pension benefit plans		Post-retirement benefit plans	
	2005	2004	2005	2004
Current service cost — DB Plans	\$ 0.3	\$ 0.4	\$ 0.8	\$ 0.7
Interest cost	5.7	5.9	2.2	2.2
Expected return on plan assets	(6.1)	(6.2)	—	—
Amortization of past service costs	1.3	1.4	—	—
Amortization of experience loss	0.3	0.7	0.6	0.6
	1.5	2.2	3.6	3.5
Current service cost — DC Plan	1.0	1.0	—	—
Expense recognized in the year	\$ 2.5	\$ 3.2	\$ 3.6	\$ 3.5

The cost of pension and other post-retirement benefits earned by employees is actuarially determined using the projected benefit method, prorated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health-care costs. Actuarial gains or losses arise from changes in benefit obligation assumptions and the difference between the expected and actual investment performance.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Staped Unit amounts

## 14. EMPLOYEE BENEFITS (continued)

The following table shows the difference between the net benefit plan expense recognized in the year based on amortization of both actuarial gains or losses and the difference between expected and actual investment performance, and the Company's net benefit plan expense (recovery) incurred in the year computed without amortization of these amounts:

	Pension benefit plans		Post-retirement benefit plans	
	2005	2004	2005	2004
Expense recognized in the year	\$ 2.5	\$ 3.2	\$ 3.6	\$ 3.5
Difference between expected and actual return on plan assets	(7.0)	(6.2)	—	—
Difference between net actuarial gains amortized and net actuarial gains arising	9.2	(1.0)	4.1	(4.1)
Difference between past service costs amortized and past service costs arising	(1.3)	(1.3)	—	—
Expense (recovery) incurred in the year	\$ 3.4	\$ (5.3)	\$ 7.7	\$ (0.6)

### Weighted-average significant assumptions:

	Pension benefit plans		Post-retirement benefit plans	
	2005	2004	2005	2004
<b>Accrued benefit obligations:</b>				
Discount rate	5.0%	6.0%	5.0%	6.0%
Rate of increase in future compensation	3.0%	3.5%	—	—
<b>Net benefit expense:</b>				
Discount rate	6.0%	6.0%	6.0%	6.0%
Assumed long-term rate of return on plan assets	7.0%	7.5%	—	—
Rate of increase in future compensation	3.0%	3.5%	—	—
<b>Assumed health-care cost trend rate at end of year:</b>				
Initial health-care cost trend	—	—	6.9%	6.9%
Annual rate of decline in trend rate	—	—	0.3%	0.3%
Ultimate health-care cost trend rate	—	—	4.2%	4.2%

### 2005 sensitivity of significant assumptions:

	Change in obligation		Change in expense	
Effect of 1% increase in health-care cost trend rates	\$	5.6	\$	0.5
Effect of 1% decrease in health-care cost trend rates	\$	(4.7)	\$	(0.4)

In order to retain and encourage the continuing service of its officers and key employees, the Company has entered into agreements with its officers and key employees providing a supplement to the severance entitlements to which these officers are entitled under their regular employment arrangements if employment is terminated without cause within 24 months following a change of control of the Company, as defined in the agreements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

### 15. STAPLED UNITS

#### (a) Authorized share capital:

10,069,608,359 common shares without par value

1,600,000 class A preferred shares with a par value of \$1.00 each

5,000,000,000 class B preferred shares without par value, of which the following have been designated in series:

32,500,000 series A preferred shares

16,000,000 series B preferred shares

1,539,000 series C preferred shares

65,840,000 series D preferred shares

10,000,000,000 preferred shares with a par value of \$0.024456 each

#### (b) Stapled Units:

The Company issues equity by way of Stapled Units, each Stapled Unit consisting of approximately \$8.98 face amount of Series A Subordinate Notes, 100 preferred shares and one common share. The securities comprising a Stapled Unit trade together as Stapled Units and cannot be transferred except with each other as part of a Stapled Unit until the date of maturity of the Series A Subordinate Notes or the payment of the principal amount of the Series A Subordinate Notes following an event of default and expiration of a remedies blockage period.

During the year ended December 31, 2005, the Company issued 580,554 Stapled Units (2004 — 660,895 Stapled Units) on the exercise of Stapled Unit options.

Details as to issued and outstanding Stapled Units are as follows:

	Number of Stapled Units	Series A Subordinate Notes	Preferred shares	Common shares	Issue costs	Total share capital and issue costs	Total Stapled Units
Balance, December 31, 2003	76,246,122	\$ 684.6	\$ 186.3	\$ 30.2	\$ (30.5)	\$ 186.0	\$ 870.6
Year ended December 31, 2004: Stapled Unit options exercised	660,895	5.9	1.6	0.2	—	1.8	7.7
Balance, December 31, 2004	76,907,017	690.5	187.9	30.4	(30.5)	187.8	878.3
Year ended December 31, 2005: Stapled Unit options exercised	<b>580,554</b>	<b>5.2</b>	<b>1.4</b>	<b>0.6</b>	<b>—</b>	<b>2.0</b>	<b>7.2</b>
Balance, December 31, 2005	<b>77,487,571</b>	<b>\$ 695.7</b>	<b>\$ 189.3</b>	<b>\$ 31.0</b>	<b>\$ (30.5)</b>	<b>\$ 189.8</b>	<b>\$ 885.5</b>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

## 15. STAPLED UNITS (continued)

### (b) Stapled Units: (continued)

Details as to each of the components of the Stapled Units are as follows:

#### (i) Series A Subordinate Notes (see note 2):

	Number of notes	Amount
Balance, December 31, 2003	76,246,122	\$ 684.6
Year ended December 31, 2004:		
Series A Subordinate Notes issued on exercise of Stapled Unit options	660,895	5.9
Balance, December 31, 2004	76,907,017	690.5
Year ended December 31, 2005:		
Series A Subordinate Notes issued on exercise of Stapled Unit options	<b>580,554</b>	<b>5.2</b>
Balance, December 31, 2005	<b>77,487,571</b>	<b>\$ 695.7</b>

Each Series A Subordinate Note has been issued with a face amount of \$8.978806569, entitling the holder to an interest payment per unit of \$1.077456788 per annum (12%). The Series A Subordinate Notes are unsecured and subordinate to all credit facilities (see note 11) and debentures (see note 12). The principal amount of the Series A Subordinate Notes plus accrued and unpaid interest thereon are due on August 31, 2038, unless such date is extended by the Company at the time of the issuance of additional Subordinate Notes to a date not later than the earlier of: (i) the date of maturity of such additional Subordinate Notes; and (ii) August 31, 2048, and will be payable by cash or, at the option of the Company, by delivery of common shares to the Subordinate Note Trustee for the benefit of the holders of the Subordinate Notes.

#### (ii) Preferred shares:

	Number of shares	Amount
Balance, December 31, 2003	7,624,612,200	\$ 186.3
Year ended December 31, 2004:		
Preferred shares issued on exercise of Stapled Unit options	66,089,500	1.6
Balance, December 31, 2004	7,690,701,700	187.9
Year ended December 31, 2005:		
Preferred shares issued on exercise of Stapled Unit options	<b>58,055,400</b>	<b>1.4</b>
Balance, December 31, 2005	<b>7,748,757,100</b>	<b>\$ 189.3</b>

The holders of the preferred shares are entitled to the receipt of dividends as may be declared by the Board of Directors from time to time and are not entitled to any voting rights except as may be provided under the Company Act. The preferred shares may be redeemed at the option of the Company in whole at any time or in part from time to time at the par value of \$0.024456 per share.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

## 15. STAPLED UNITS (continued)

### (b) Stapled Units: (continued)

#### (iii) Common shares:

	Number of shares	Amount
Balance, December 31, 2003	76,246,122	\$ 30.2
Year ended December 31, 2004:		
Common shares issued on exercise of Stapled Unit options	660,895	0.2
Balance, December 31, 2004	76,907,017	30.4
Year ended December 31, 2005:		
Common shares issued on exercise of Stapled Unit options	<b>580,554</b>	<b>0.6</b>
Balance, December 31, 2005	<b>77,487,571</b>	<b>\$ 31.0</b>

### (c) Class B preferred shares issuable in series:

Details as to the series of class B preferred shares issued are as follows:

Series A	Number of shares	Amount
Preferred shares outstanding, December 31, 2004 and 2003	32,500,000	\$ 325.0
Year ended December 31, 2005:		
Preferred shares redeemed	<b>(6,000,000)</b>	<b>(60.0)</b>
Preferred shares outstanding, December 31, 2005	<b>26,500,000</b>	<b>265.0</b>
Preferred shares owned by the Company's subsidiaries	<b>(26,500,000)</b>	<b>(265.0)</b>
Balance, December 31, 2005 and 2004	<b>—</b>	<b>\$ —</b>
Series D	Number of shares	Amount
Preferred shares outstanding, December 31, 2004 and 2003	62,500,000	\$ 625.0
Year ended December 31, 2005:		
Preferred shares redeemed	<b>(32,700,000)</b>	<b>(327.0)</b>
Preferred shares outstanding, December 31, 2005	<b>29,800,000</b>	<b>298.0</b>
Preferred shares owned by the Company's subsidiaries	<b>(29,800,000)</b>	<b>(298.0)</b>
Balance, December 31, 2005 and 2004	<b>—</b>	<b>\$ —</b>

The Company redeemed 6,000,000 Series A class B preferred shares and 32,700,000 Series D class B preferred shares held by the Company's subsidiary companies as part of an internal capital reorganization undertaken during the year ended December 31, 2005.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Staped Unit amounts*

### 16. COMMITMENTS AND CONTINGENCIES

#### (a) Operating leases:

At December 31, 2005, the Company was committed to payments under operating leases for equipment and office premises through to 2011 in the amount of approximately \$4.0 million. Annual payments over the term of these commitments are as follows:

2006	\$	1.0
2007		0.9
2008		0.7
2009		0.7
2010		0.6
Thereafter		0.1
Total operating lease commitments		\$ 4.0

#### (b) Letters of credit:

At December 31, 2005, the Company had commitments of \$15.9 million (2004 — \$15.9 million) relating to outstanding letters of credit issued under its available credit facilities, which secure various obligations of the Company.

#### (c) Legal claims:

The Company is subject to legal proceedings and claims that arise in the ordinary course of its business. Although there can be no assurance as to the disposition of these matters and the proceedings, it is the opinion of the Company's management, based upon the information available at this time, that the expected outcome of these matters, individually or in aggregate, will not have a material adverse effect on the results of operations and financial condition of the Company.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

In millions of dollars, except per common share and per Stapled Unit amounts

## 17. STOCK-BASED COMPENSATION PLANS

### (a) Stapled Unit Option Plan:

Under the Stapled Unit Option Plan established in 2000, the Company may grant options for the purchase of Stapled Units to directors, officers or employees who are in active service or employment with the Company or any of its subsidiaries. The maximum number of Stapled Units that may be issued pursuant to this plan and all options granted thereunder is limited to 3,500,000 Stapled Units. The expiry date and vesting provisions of options granted are established at the time an award is made. Options granted in 2000 expire 10 years from the date of grant and options granted from 2001 onwards expire 5 years from the date of grant. All options vest in equal proportions over a period of three years. The exercise price of grants awarded may not be less than the weighted average trading price of the Stapled Units on the Toronto Stock Exchange over the five consecutive trading days immediately before the date of grant.

Activity in the Company's Stapled Unit Option Plan for fiscal 2005 and 2004 was as follows:

	2005		2004	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Options outstanding, beginning of year	1,157,578	\$ 12.09	1,518,733	\$ 11.87
Granted	348,998	15.79	313,220	12.21
Exercised	(580,554)	12.17	(660,895)	11.64
Cancelled	(70,543)	14.33	(10,260)	12.08
Expired	—	—	(3,220)	11.90
Options outstanding, end of year	855,479	\$ 13.36	1,157,578	\$ 12.09

A summary of Stapled Unit options outstanding at December 31, 2005, is as follows:

Number of options	Total outstanding			Total exercisable	
	Exercise price	Weighted average exercise price	Weighted average years to expiration	Number of options	Weighted average exercise price
37,000	\$ 8.91	\$ 8.91	4.2	37,000	\$ 8.91
168,596	11.90	11.90	2.1	91,183	11.90
250,158	12.21	12.21	3.2	66,015	12.21
2,580	12.28	12.28	2.2	1,720	12.28
25,000	12.72	12.72	0.9	25,000	12.72
35,530	12.84	12.84	0.9	35,530	12.84
25,670	13.03	13.03	1.0	25,670	13.03
4,234	13.41	13.41	1.4	4,234	13.41
6,000	14.98	14.98	4.4	—	—
300,711	15.80	15.80	4.1	—	—
<b>855,479</b>	<b>\$ 8.91 – 15.80</b>	<b>\$ 13.36</b>	<b>3.1</b>	<b>286,352</b>	<b>\$ 11.90</b>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

## 17. STOCK-BASED COMPENSATION PLANS (continued)

### (a) Stapled Unit Option Plan: (continued)

Prior to January 1, 2003, the Company's policy was that no compensation cost was recorded on stock-based compensation awards granted to employees under this plan. Effective January 1, 2003, the Company changed its policy of accounting for awards under this plan and now applies the fair value-based method of accounting for all stock-based compensation transactions.

The Company made this change in accounting policy on a prospective basis and accordingly has not applied the fair value-based method of accounting to Stapled Unit options granted between January 1, 2002, and December 31, 2002. The compensation cost for the 55,200 Stapled Unit options granted under the Stapled Unit Option Plan in 2002, determined based on their fair value at the grant date of the awards, consistent with the fair value method of accounting for stock-based compensation, is \$0.1 million. As this amount would be amortized against income over the three-year vesting period of the underlying options, the Company's pro forma net earnings and pro forma earnings per common share if this amount was expensed would not differ from the amounts reported for the years ended December 31, 2005 and 2004.

The compensation cost for the 348,998 Stapled Unit options granted under the Stapled Unit Option Plan in 2005, determined using the fair value method of accounting for stock-based compensation, is \$0.5 million. As this amount is amortized against income over the three-year vesting period of the underlying options, a charge of \$0.2 million was recognized in net earnings for the year ended December 31, 2005, with a corresponding credit to contributed surplus.

The compensation cost for the 313,220 Stapled Unit options granted under the Stapled Unit Option Plan in 2004, determined using the fair value method of accounting for stock-based compensation, is \$0.3 million. As this amount is amortized against income over the three-year vesting period of the underlying options, a charge of \$0.1 million was recognized in net earnings for the year ended December 31, 2005 (2004 — \$0.1 million), with a corresponding credit to contributed surplus.

The compensation cost for the 267,047 Stapled Unit options granted under the Stapled Unit Option Plan in 2003, determined based on their fair value at the grant date of the awards, consistent with the fair value method of accounting for stock-based compensation, was \$0.3 million. As this amount is amortized against income over the three-year vesting period of the underlying options, a charge of \$0.1 million was recognized in net earnings for the year ended December 31, 2005 (2004 — \$0.1 million), with a corresponding credit to contributed surplus.

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

	2005	2004
Risk-free interest rate	3.5%	3.5%
Expected life (years)	5.0	5.0
Expected volatility	20.0%	20.6%
Dividend yield	6.8%	8.6%
Number of options granted	348,998	313,220
Weighted average fair value of options granted	\$ 1.30	\$ 0.86

Consideration paid by option holders on the exercise of these options is recorded as an addition to Stapled Units.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

## 17. STOCK-BASED COMPENSATION PLANS (continued)

### (b) Distribution Equivalent Plan:

The Distribution Equivalent Plan was introduced as a supplement to the Stapled Unit Option Plan in 2001. Under this supplemental plan, the Company awards Stapled Unit option holders an amount equal to actual distributions paid on the Company's Stapled Units. Awards granted under the Distribution Equivalent Plan vest under the same terms that apply to the corresponding options and can only be exercised at the time of exercise of the corresponding options.

The Company applies the principles of the fair value-based method of accounting for stock-based compensation to awards granted under this plan. Awards are accrued on a basis equal to actual distributions paid on the Company's issued and outstanding Stapled Units and are charged to income as the underlying Stapled Unit options vest. For the year ended December 31, 2005, \$1.1 million (2004 — \$1.3 million) has been accrued for awards granted under this plan and \$1.1 million (2004 — \$1.3 million) has been amortized against net earnings.

## 18. SEGMENT INFORMATION

The Company has one reportable segment, being solid wood, identified based on the way that management organizes its business for making operating decisions and assessing performance. All of the Company's assets are located in British Columbia, Canada.

Sales by product are as follows:

	2005	2004
Logs	\$ 327.9	\$ 337.6
Lumber	92.2	106.2
Wood chips and other	23.0	22.4
Real estate	15.1	10.8
	<b>\$ 458.2</b>	<b>\$ 477.0</b>

Sales by geographic area are as follows:

	2005	2004
Canada	\$ 186.1	\$ 225.6
Japan	153.5	160.6
United States	80.0	56.0
China	13.4	10.2
Korea	12.6	6.0
Belgium	5.5	10.5
Australia	3.7	3.5
Taiwan	3.4	4.6
	<b>\$ 458.2</b>	<b>\$ 477.0</b>

Revenues are attributed to geographic area based on final shipping destination.

In 2005, the Company had sales to one customer whose individual purchases accounted for approximately 11% of the Company's consolidated sales. In 2004, the Company had sales to one customer whose individual purchases accounted for approximately 12% of the Company's consolidated sales.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | Years ended December 31, 2005 and 2004

*In millions of dollars, except per common share and per Stapled Unit amounts*

### 19. FINANCIAL INSTRUMENTS

#### (a) Fair values:

The carrying values of accounts receivable, accounts payable and accrued liabilities and distribution payable approximate their fair values due to the short term to maturity of these instruments.

The carrying values of receivables on the sale of property, plant and equipment are estimated to approximate their fair values due to their short term to maturity.

The carrying values of drawings on available credit facilities approximate their fair values, as they bear floating interest rates that approximate market rates and have a short term to maturity.

The carrying value of accrued liabilities for future silviculture costs approximate their fair value as determined based on the present value of future cash flows associated with these liabilities.

At December 31, 2005, the Company's 7.0% debentures had a carrying value of \$195.0 million (2004 — \$195.0 million) and a fair value of \$200.2 million (2004 — \$206.8 million). The debenture fair values have been estimated based on quotes provided by financial institutions as at December 31, 2005 and 2004.

At December 31, 2005, the Company's Series A Subordinate Notes owned by unitholders had a carrying value of \$695.7 million (2004 — \$690.5 million). The Series A Subordinate Notes are a component of the Company's Stapled Units, which include one common share, 100 preferred shares and approximately \$8.98 face amount of the 12% Series A Subordinate Notes. The Stapled Units are listed on the Toronto Stock Exchange. The fair value of the Stapled Units as at December 31, 2005, was \$1,193.3 million based on quoted market price. The Company has not determined the allocation of the fair value of the Stapled Units to the individual components as at December 31, 2005, as it is not practical to do so, however, the Company estimates that the fair value of the Series A Subordinate Notes would not differ materially from their carrying value.

#### (b) Credit risk:

The Company is exposed to credit risk on accounts receivable from customers. To manage its credit risk, the Company has credit policies that include the analysis of the financial position of its customers and the regular review of their credit limits. In certain offshore markets, the Company requires bank letters of credit.

### 20. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year presentation.

## EXECUTIVE MANAGEMENT TEAM & BOARD OF DIRECTORS

### Executive Management Team

**Paul J. McElligott**

President and Chief Executive Officer  
North Vancouver, British Columbia

**John A. Kelvin**

Vice-President, Log Marketing and Sales  
North Vancouver, British Columbia

**Hamish Kerr**

Vice-President, Strategic Planning  
and Forest Policy  
West Vancouver, British Columbia

**Beverlee F. Park**

Vice-President, Finance,  
and Chief Financial Officer  
West Vancouver, British Columbia

**Eddy R. Vervynck**

General Manager, Manufacturing  
Salmon Arm, British Columbia

**Gerald G. Young**

Vice-President, Timberland Operations  
Courtenay, British Columbia

### Board of Directors

**Clark S. Binkley**<sup>1, 3</sup>

Managing Director, International Forestry  
Investment Advisors, LLC;  
Corporate Director  
Boston, Massachusetts  
Director since 2005

**William C. Brown**<sup>1, 2</sup>

Corporate Director  
West Vancouver, British Columbia  
Director since 1997

**V. Edward Daughney**<sup>2, 3</sup>

Chairman, TimberWest Forest Corp.;  
Principal and Chairman,  
Echelon Home Products Ltd.;  
Corporate Director  
Vancouver, British Columbia  
Director since 1997

**Paul J. McElligott**

President and Chief Executive Officer,  
TimberWest Forest Corp.  
North Vancouver, British Columbia  
Director since 1997

**Robert W. Murdoch**<sup>1, 2, 4</sup>

Corporate Director  
Salt Spring Island, British Columbia  
Director since 2001

**Conrad A. Pinette**<sup>1, 3</sup>

Corporate Director  
Vancouver, British Columbia  
Director since 2002

**Kenneth A. Shields**<sup>2, 4</sup>

Chairman, Raymond James Ltd.;  
Corporate Director  
Vancouver, British Columbia  
Director since 1997

### Committees of the Board

<sup>1</sup> Audit

<sup>2</sup> Governance & Human Resources

<sup>3</sup> Environment, Health & Safety

<sup>4</sup> Pension

For full descriptions of the Board committees,  
please see TimberWest's [Annual Information Form](#).

Bios for members of the Executive Management Team and Board of Directors  
are available on TimberWest's web site at: [www.timberwest.com/compinfo\\_directors.cfm](http://www.timberwest.com/compinfo_directors.cfm)



## TIMBERWEST OFFICES & OPERATIONS

### Corporate Head Office

TimberWest Forest Corp.  
Suite 2300 – 1055 West Georgia Street  
PO Box 11101  
Vancouver, BC  
Canada V6E 3P3  
Telephone: 604-654-4600

### Nanaimo Regional Office

TimberWest Forest Corp.  
No. 3, 4890 Rutherford Road  
Nanaimo, BC V9T 4Z4  
Telephone: 250-729-3700

### North Island Operations

TimberWest Forest Corp.  
5705 North Island Highway  
Campbell River, BC V9W 5C5  
Telephone: 250-287-9181

### South Island Operations

TimberWest Forest Corp.  
No. 3, 4890 Rutherford Road  
Nanaimo, BC V9T 4Z4  
Telephone: 250-729-3700

### Log Distribution

TimberWest Forest Corp.  
No. 3, 4890 Rutherford Road  
Nanaimo, BC V9T 4Z4  
Telephone: 250-729-3700

### Seed Orchard

Mount Newton Seed Orchard  
1450 Mount Newton Cross Road  
Saanichton, BC V8M 1S1  
Telephone: 250-652-4211

### Aerial Fire Attack

Flying Tankers Inc.  
9350 Bomber Base Road  
Port Alberni, BC V9Y 8Z3  
Telephone: 250-723-6225

### Lumbermill

Elk Falls Lumbermill  
No. 1 Quality Drive  
PO Box 3300  
Campbell River, BC V9W 8A3  
Telephone: 250-287-5700

### Shipping Facilities

Stuart Channel Wharves  
8359 Crofton Road  
PO Box 40  
Crofton, BC V0R 1R0  
Telephone: 250-246-3234

### Transfer Agent & Registrar

Computershare Investor Services Inc.  
at its principal offices in Vancouver  
and Toronto

### Auditors

KPMG LLP  
Vancouver, BC

### Securities Listed

Stapled Units (Symbol: TWF.UN)  
Toronto Stock Exchange

### Investor Relations Contact

Bev Park, Vice-President, Finance,  
and Chief Financial Officer  
Telephone: 604-654-4600  
Facsimile: 604-654-4662  
E-mail: invest@timberwest.com

---


## 2006 ANNUAL GENERAL MEETING

Thursday, April 27, 2006, at 2:00 pm (PDT)

The 2006 Annual General Meeting of the unitholders of Stapled Units of TimberWest Forest Corp.  
will be held at the Metropolitan Hotel, 645 Howe Street, Vancouver, BC, Canada V6C 2Y9.

Telephone: 604-687-1122 • Facsimile: 604-689-7044





TimberWest's extensive portfolio of residential and rural development lands includes undeveloped property close to several fast-growing communities, including that shown here near Campbell River, BC.

**Creative Direction, Graphic Design & Production:**  
MPA Communication Design Inc. with Nimble Creative  
**Prepress & Printing:** Rhino Print Solutions Inc.  
PRINTED IN CANADA © 2006

Waite Air Photos Inc.





TimberWest Forest Corp.  
Suite 2300 - 1055 West Georgia Street  
Vancouver, BC, Canada V6E 3P3