



TIMBERWEST FOREST CORP.

2010
ANNUAL REPORT

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Letter to Our Unitholders from the Chairman

Dear Unitholders,

Having come through the worst years in our history, 2010 witnessed a decidedly improving trend in TimberWest's results. Considerable strength in Asian log markets drove our timberland earnings improvement with the Company's export volumes and prices reaching record levels in China and Korea in particular. This combined with strong real estate sales meant the Company ended the year with four consecutive quarters of positive EBITDA.

The Board of Directors maintained its focus this year on ensuring the Company was well-positioned to emerge stronger out of this downturn. The equity issue completed in May 2010 was a key event in this regard allowing TimberWest to materially reduce debt and improve liquidity. This, as well as the Company's improved earnings trend, positions us well for refinancing our debt later in 2011. The Board also continued the deferral of distributions on the stapled units, which will continue in 2011. The Company will determine on a quarterly basis as to whether deferred distributions will be paid in cash or by the issuance of additional Stapled Units.

From the Board and throughout the organization, TimberWest has continued its unwavering commitment to safety. I am pleased to report that the Company has delivered another strong year for safety performance demonstrating that our focus on and adherence to leading safety systems is working. TimberWest follows the SAFE Companies program of the B.C. Forest Safety Council. In order to achieve SAFE Company certification, organizations must undergo a comprehensive external audit of their health and safety programs and processes every three years, supplemented by annual internal audits. TimberWest is committed to providing the leadership necessary to achieving a truly excellent program and as a result is recognized as an industry leader in working with contractors to achieve and maintain a safe workplace. The Company completed its re-certification audit for 2010 and achieved a score of 95.7% - our highest ever.

TimberWest also manages its assets for long-term sustainability to assure a steady and continuing flow of high quality timber while working cooperatively with its neighboring communities. Protection of biodiversity is a key element of sustainable forest management and TimberWest continually strives to improve efforts to sustain key habitat for plants and wildlife. This endeavor is not only part of delivering on our social and environmental license to operate, it meets the increasing market demand for products from timberlands that have been independently certified as having high standards of environmental management.

TimberWest has achieved third party certification of all operations under ISO 14001 and of our private and public lands under the Sustainable Forestry Initiative. In addition, the Company's private forest lands are bound by over 35 different legislative regulations. TimberWest's field performance in 2010 has once again demonstrated the whole organization's commitment to not only adhering to the regulations, but delivering on its social commitment to sustainable practices.

The Company is taking this dedication to sustainability to all other parts of the business as well. Couverdon, in particular, is committed to being a full partner in Vancouver Island's future, investing in and building the community. Pursuing the triple bottom line approach of an economically, environmentally and socially sustainable Vancouver Island, Couverdon is dedicated to innovative management of its lands, including the development of sustainable communities to benefit current and future generations.

As well, these principles are a natural fit as we pursue new revenue streams to enhance unitholder value in the areas of carbon sequestration and alternative energy, as further discussed in the CEO's letter to unitholders.

Optimism in log markets combined with the excellent work management has done over the past decade in cost improvement and our stronger balance sheet all point to much better times ahead for TimberWest.

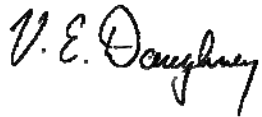
Letter to Our Unitholders from the Chairman

During 2010, the Board undertook a review of its Governance practices to ensure that we are adhering to leading Governance policies. The protocols we had in place proved to set a high standard of Governance for the Company and required only minor changes.

On behalf of the Board of Directors I would like to thank all of the employees and our contractors for their continued focus on delivering value to our unitholders while also delivering excellent safety, stewardship and sustainability results.

Finally, I retire from the Board at the Annual General Meeting in April 2011 after fourteen years as Chairman. As a result, this will be my last annual letter to unitholders. It has been a privilege to serve the unitholders, directors, management and employees of this Company and a pleasure to work with the many great directors who have devoted time, energy and wisdom to the leadership of this organization.

On behalf of the Board of Directors,

A handwritten signature in black ink that reads "V. E. Daughney". The signature is written in a cursive style with a large, prominent initial "V".

V. Edward Daughney, Chairman of the Board

Letter to Our Unitholders from the CEO

Dear Unitholders,

Overview

I am pleased to report that the fourth quarter of 2010 was another quarter of positive EBITDA for TimberWest. We have now delivered four consecutive quarters of positive EBITDA, evidencing the fact that a long awaited recovery is clearly underway. EBITDA for the quarter was \$5.7 million compared to (\$1.1) million in Q4, 2009. For the year overall, EBITDA was \$21.2 million, a \$28.5 million improvement over 2009 when EBITDA was (\$7.3) million. A Distributable Cash loss of \$3.2 million was recorded in the quarter, bringing the total Distributable Cash loss for the year to \$6.8 million. This is a meaningful improvement over the Distributable Cash loss of \$34.7 million for 2009. Driving these improved results is a continuation of increased demand, primarily to Asia, and rising fibre prices in that region. Strong economic growth in China and Korea, improved port access, and a decline in Russian log supply, have provided a stable platform for TimberWest to further diversify sales and increase its supply to these markets. 2010 marks the first year when more than half of the Company's log sales volumes were to international markets.

The Company ended the year with improved liquidity and a stronger balance sheet, primarily as a result of the Stapled Unit offering which closed in May, 2010. This initiative raised \$56.8 million in net proceeds, which were applied to reduce the Company's operating credit facility. Based on this, plus the improvements in profitability, the Company resumed paying the interest on its convertible debentures in cash, thereby minimizing ongoing dilution, and net operating debt ended the year at \$103.0 million, down from \$150.8 million at year-end 2009.

During the fourth quarter, TimberWest also started paying the previously deferred Stapled Unit distributions. These payments were made in kind by issuance of additional Stapled Units with the first payment made in October, 2010. The next payment was made subsequent to year-end in January, 2011. These quarterly deferred distributions will continue throughout 2011. The Company will determine on a quarterly basis as to whether deferred distributions will be paid in cash or by the issuance of additional Stapled Units.

Timberlands

Sales volume for the quarter was 0.7 million m³, bringing the total for the year to 3.0 million m³. This is the highest sales volume achieved since 2006 and it is 67% higher than 2009. The Company's private land harvest increased to 1.8 million m³ in 2010 from 1.2 million m³ in 2009, while its public land harvest increased to 0.7 million m³ from 0.3 million m³ in 2009. Higher harvest levels combined with additional log purchases were in response to strong demand from Asia. Record volumes to China of 372,000 m³ in 2010 were an increase of 3.5 times over the previous year, while volumes to Korea increased 2.3 times to a record volume of 238,000 m³. Record volumes to Japan of 852,000 m³ in 2010 were a 76% increase over the prior year and, at those levels, TimberWest is the largest Canadian supplier of logs into that country.

The average sales realization in the fourth quarter was \$72 per m³ and \$73 per m³ for the year overall, an increase of \$3 per m³ over 2009. This modest increase was realized in spite of an 11% increase in the value of the Canadian dollar relative to its US counterpart. The Canadian dollar was at \$0.99 during the fourth quarter and \$0.97 for the year overall. Some two thirds of the Company's 2010 log sales revenue were derived from transactions denominated in US dollars.

Average sales realizations in 2010 were constrained by the increased volume of lower value hemlock in the Company's sales mix. The incremental harvest in 2010 was focused heavily on hemlock increasing its share of the total harvest mix by 20% over 2009. Hemlock represented 36% of the sales mix in 2010 while fir declined to 55% from 58% in 2009. While the average sales realization of hemlock in all markets was \$16 per m³ lower than the sales realization for fir in 2010, the price differential in China and Korea was much less significant. For sales to

Letter to Our Unitholders from the CEO

China and Korea in 2010, the average second growth fir realization was \$86 per m³ while the average second growth hemlock realization was \$85 per m³. The average hemlock sales realization in China and Korea increased 18% in 2010, from \$72 per m³ in 2009 to \$85 per m³ in 2010, despite the appreciation of the Canadian dollar.

The Company's various cost reduction programs and its sub-divided contractor model for timber harvesting operations demonstrated positive results at these higher harvest levels. The cost of sales was \$63 per m³ in Q4, 2010 and \$64 per m³ for the year overall. This compares to a cost of sales of \$71 per m³ in 2009.

While the Company did not celebrate its best year on record from a safety and environmental perspective, it had a very strong year on both fronts. The 2010 Medical Incident Rate of 0.6 was only slightly higher than the previous year at 0.5.

In terms of environmental stewardship, the Company was notified of two minor non-conformances, with no major non-conformances, when third party compliance audits were undertaken of the Company's environmental certifications during the year.

Couverdon

Couverdon continues to work on a variety of planning and rezoning projects in southeastern Vancouver Island. These projects are multi-year programs. That said, Couverdon was successful achieving approvals on the creation of 110 large acreage lots at different locations in 2010. It is also at fourth reading with the City of Campbell River on a 160 acre rezoning which includes 1,100 new residential units and 50,000 square feet of new commercial space. Early in 2011, Couverdon also tabled a boundary extension and development proposal with the community of Ladysmith for a significant new mixed use village.

Couverdon continues as an active participant in Regional Growth Strategy and Official Community Plan amendment discussions in communities as those communities develop their visions and plans for future growth.

Land sales for the year 2010 were \$13.0 million at an average per acre value of \$4,390. This is comparable to last year's revenue and represents strong value for the product type marketed in the year.

Couverdon's focus in 2011 will be twofold. First, it will continue to work on unlocking the value of the Company's core development nodes by pursuing multi-year planning and rezoning programs with communities. Second, and with greater impact on short term financial results, it will continue to monetize non-core lands not identified for value enhancement programs and targeted for disposition. This sales program, which focuses on large acreage lots, monetizes land at a premium over timberland values and will be comparable in size to Couverdon's 2010 sales program. For non-core land sales, Couverdon is expected to continue at this pace in the years ahead until its newly entitled core development properties get added to the sales offering.

Emerging New Revenue Streams

It was noted this time last year that climate change and a growing international movement for cleaner, more environmentally friendly and sustainable products and services is creating new business opportunities for TimberWest on its sizeable land base. Over the past twelve months, the Company has completed a pre-feasibility study on wind power, the results of which look promising. We have moved to the next stage of investigation by installing meteorological towers at several different locations on our land base to allow for the collection of site specific data on the wind resource. The next step will be to enter into a joint venture arrangement with a wind operating and development company. We anticipate doing so early in 2011.

In response to BC Hydro's Phase II Biomass Power Call, the Company formed a strategic partnership in 2010 with Boralex Inc., which owns and operates eight biomass power plants in North America, and Pacific BioEnergy Corp., Canada's second largest wood pellet producer. The partnership subsequently submitted a proposal for a biomass

Letter to Our Unitholders from the CEO

power facility to be constructed on the Company's former Elk Falls sawmill site located in Campbell River. The proposed facility would be fuelled by woody biomass sourced from unutilized harvest and mill residues from central and northern Vancouver Island. If approved, it would produce power under long term contract to BC Hydro and, if sufficient fibre availability exists and market conditions permit, a second plant would be constructed on the same site to manufacture wood pellets for the export market. Subsequent to year-end, BC Hydro selected the TimberWest consortium as one of its Preferred Proponents to advance to the next stage of negotiation of a long term Energy Purchase Agreement. The Company should know by mid 2011 whether this project proceeds to construction.

Finally, early in 2010 the Company made a submission to Pacific Carbon Trust (PCT) for a carbon offset project focused on the conservation of selected old growth stands on its private lands. Discussions with PCT and analysis of the project continued through the year and in the fourth quarter TimberWest and PCT reached fundamental agreement on a Term Sheet for a carbon sequestration project on TimberWest lands. Prior to offsets being available for sale, a Project Description Document must be completed and obtain third party validation and verification. Work is underway to complete the Company's Project Description Document and the validation process is expected to be completed by mid- year, 2011. Subsequent to year-end, the Company and Pacific Carbon Trust signed the term sheet and are working on a definitive agreement.

We are pleased with the progress reached in these areas in 2010. As noted this time last year, it is difficult to predict the exact timing, because of the state of flux with renewable and ecosystem based services, but it appears likely that new revenue streams will materialize with one or more of the opportunities identified. We now believe that will be proven true as early as 2011.

International Financial Reporting Standards ("IFRS") & Opening Balance Sheet

We have made substantial progress on the work associated with determining the values associated with our opening IFRS balance sheet. The significant adjustments relating to the IFRS adoption in 2011 are highlighted in the accompanying MD&A and will be aggregated to form one amendment to retained earnings on the initial IFRS balance sheet. The initial IFRS related charge to retained earnings is expected to be in the range of \$160 million to \$210 million.

This is not the first time that our asset values have been impacted by changes in accounting standards. In 2000 changes on how Canadian Generally Accepted Accounting Principles addressed the tax affect on asset purchases increased our asset values by \$402.3 million in timberland assets. Under IFRS our Private Timberlands and HBU properties will now be fair valued on an annual basis without consideration of tax values. With the change over to IFRS, asset values will vary from year to year depending on the underlying fair value of those assets.

Outlook

Business conditions improved significantly in 2010 and further improvement is expected in 2011 and beyond. The rapid emergence of Asia over the past two years has created a new paradigm for TimberWest, favourably impacting both log volumes and prices. Importantly, Asian demand is driving log prices not only in Asia but in North America and this has been the case since Q2, 2009 when prices generally started their gradual, steady climb to where they are today. In spite of cyclical lows in the level of US housing starts, by the beginning of Q1, 2011, prices for hemlock logs off of private land in the US Pacific Northwest ("US PNW") were higher than at the peak reached in 2006 when US housing starts were at a cyclical high. Similarly, Douglas fir pricing is now at its highest level since 2006 and within 15% of its peak that year in the US PNW. With both species, growth in Chinese demand is the driver.

Letter to Our Unitholders from the CEO

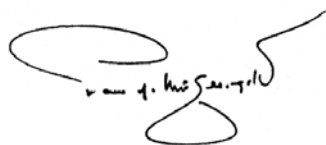
As we look forward, softwood demand in China is projected to continue increasing as a result of general economic growth and there is expected to be a continuing fibre supply gap. Japan is expected to remain strong and stable. In the US, the housing market is expected to gradually recover after its lengthy downturn. During the same period of time that the US housing industry rebuilds, supply restrictions caused by the Mountain Pine Beetle epidemic that are already being felt will become progressively worse.

Over the next few years, we anticipate steadily improving US housing starts until we get back to a sustainable level of some 1.6 to 1.7 million new housing starts per year, continued demand growth in Asia, tightening log supply in North America and restricted log flow out of Russia. All of this is expected to result in meaningfully higher log prices and improved margins for TimberWest. If the US dollar regains some of its strength, the impact on TimberWest sales realizations will be even more positive.

In addition to real estate properties, we will see further development in the measurement and subsequent sale of carbon credits as well as advances in our wind and biomass energy projects. With the exception of carbon credits, these projects have a long term gestation period and, as such, will not have any meaningful impact on 2011 results. With respect to carbon credits, 2011 should see our first sale. Though the initial program will be small, we envision growing carbon sales to a meaningful level in future years.

Closing Comments

Before closing, it should be noted that 2010 is the last full year that Ed Daughney will serve as Chairman of the TimberWest Board of Directors. Ed retires from the TimberWest board after the April, 2011 board meeting. As one of the founding members, Ed joined the TimberWest board in 1997 when the Company was first established and he has served as Chairman ever since. On behalf of the management team, and my fellow directors, I would like to thank Ed for his many years of service to TimberWest. He has devoted considerable time and energy to serving unitholders over the years, he was a pleasure to work with, and he will be missed. I wish him well in his retirement years.

A handwritten signature in black ink, appearing to read "Paul J. McElligott". The signature is stylized with a large loop at the beginning and a long, sweeping tail that ends in a hook.

Paul J. McElligott, President and Chief Executive Officer

February 10, 2011

Management's Discussion & Analysis

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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 2010 relative to 2009. 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, earnings available for distribution and earnings before interest, tax, depreciation and amortization ("EBITDA"). Distributable cash, earnings available for distribution and EBITDA are considered key measures by TimberWest in evaluating the Company's operating performance and the level of distributions payable on its Stapled Units held by unitholders. Distributable cash, earnings available for distribution and EBITDA 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, as determined in accordance with GAAP, and earnings available for distribution, distributable cash and EBITDA 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 10, 2011, 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 <http://www.sedar.com>.

Forward Looking Statements

The statements which 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, variations in harvest levels, changes in log transportation costs, actions of competitors, interest rate and foreign currency fluctuations, regulatory, harvesting fee and trade policy changes and other actions by governmental authorities including real estate zoning approvals, the 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 in TimberWest's public filings with securities regulatory authorities.

Management's Discussion & Analysis

Overview

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 sawmill operations, all largely located on Vancouver Island in 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. The Company has evolved into a timber and land management company. It harvests timber on its lands, and develops and sells higher value real estate lands. The private timberlands were acquired in 1997 for \$842.4 million, or \$1,021 per acre, or \$2,522 per hectare, and to date TimberWest has made distributions of \$883.9 million to its unitholders.

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 319,000 hectares or 787,000 acres of private forest lands support the growth of Douglas fir, a premium tree species sought after for structural purposes. Over the previous five years these private forest lands have provided an annual average harvest of 1.9 million m³ of logs.

TimberWest currently holds renewable long-term public tenures which provide the Company with the right to an average harvest of 0.7 million m³ logs per year from Crown lands. In 2010, the Company harvested 0.7 million m³ from Crown lands. The management practices applied to these lands meet the stringent requirements of the Forest and Range Practices Act.

The Company's independent auditor, KPMG Performance Registrar Inc., periodically certifies that forest management practices on the Company's private and public timberlands continue to meet all Sustainable Forestry Initiative (SFI®) requirements. SFI requirements specify that forest harvesting is integrated with environmental and conservation goals for soil, wildlife, water quality protection, conservation of biodiversity, protection of special sites and aesthetics in a manner that ensures a sustainable harvest over the long-term.

TimberWest has identified 56,000 acres of land that, over an extended period of time, will have a higher and better use than timberland. This represents about 7% of the Company's landholdings. This is the portion of the land base that has the highest potential value to be realized from planning and zoning changes. This land is suitable for residential, commercial, industrial, and resort development.

TimberWest had previously disclosed that 134,000 acres of land that, over an extended period of time, will have a higher and better use than timberland. The initial analysis was that over a very long period of time, a larger portion of the land base will have a higher and better use than timberland. Although the Company still believes this to be the case, the holding period is beyond a normal planning cycle. With the benefit of additional studies and review, the Company has determined 56,000 acres to be the relevant higher and better use land base for the foreseeable future. The result of this further analysis is that the Company will be able to better focus on a smaller portfolio of higher and better use land and pursue planning and zoning changes to achieve the highest potential value.

The focus of the real estate group is to work closely with Vancouver Island communities to determine the best use of these lands.

From time to time the Company will sell land "as is". For these properties, analysis indicates that TimberWest would not benefit from spending additional resources on this land to plan and entitle it, but should rather go through an orderly disposition of the properties. The value of these properties for real estate purposes exceeds their value in a forestry operation.

Management's Discussion & Analysis

Capability to Deliver Results

Financial capability

At December 31, 2010 the Company had outstanding bank debt of \$106.5 million on a revolving credit facility and cash on hand of \$3.5 million. The Company has sufficient financial capability to manage its operations with \$102.5 million undrawn on a \$220.0 million facility.

Non-financial capability

TimberWest has a highly skilled and well trained workforce. The Company also has effective internal controls 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, infrastructure, information systems and inventory at appropriate levels to ensure that the Company can respond to changing market conditions.

Highlights & Significant Transactions

Financing and liquidity

On May 18, 2010 the Company successfully raised \$60.0 million through a public Stapled Unit offering consisting of 12,000,000 Stapled Units at a price of \$5.00 per Stapled Unit for total net proceeds of \$56.8 million. Proceeds from the offering were applied to the Company's operating credit facility.

In conjunction with this offering, the Company amended its credit agreement to allow for the payment of interest on the convertible debentures to be made in cash. The Company recommenced paying its convertible debenture interest in cash starting with the July 15, 2010 payment.

The complete terms of the revolving credit agreement, including subsequent amendments, are filed on SEDAR.

Distributions on the Stapled Units

As announced in November, 2008, the January 15, 2009 distribution payment was deferred for 27 months pursuant to the terms of the Note Indenture and all 2010 and 2009 distribution payments, payable at 2%, were deferred for 18 months. The Company has set the variable interest rate at 2% for 2011 and intends to defer distribution payments for the foreseeable future.

The deferred distribution originally payable on April 15, 2009 but deferred for 18 months became payable on October 15, 2010 and was paid in kind by issuance of 885,447 Stapled Units. Subsequent to year end, the deferred distribution originally payable on July 15, 2009 but deferred for 18 months was paid in kind on January 17, 2011 by issuance of 785,854 Stapled Units. Concurrent with the January 17, 2011 payment, the cumulative effect of the April 15, 2009 and the July 15, 2009 deferred interest payments paid by issuance of Stapled Units on October 15, 2010 and January 17, 2011, respectively, was 1.8% and resulted in a conversion price adjustment from \$3.50 to approximately \$3.44 on the convertible debentures under the conversion price privilege. In April, 2011, the Company will pay deferred distributions in the amount of \$24.5 million by issuing additional Stapled Units. The issuance of these additional Stapled Units will result in a further reduction to the conversion price of the convertible debentures. The Company will determine on a quarterly basis as to whether deferred distributions will be paid in cash or by the issuance of additional Stapled Units.

Strategic Land Acquisition

Subsequent to year end, on February 9, 2011, the Company has agreed to acquire 7,678 hectares of private timberland located adjacent to the Company's existing private timberlands on southern Vancouver Island from

Management's Discussion & Analysis

Western Forest Products Inc. The purchase price is \$21.9 million and will be funded through the Company's existing credit facility. Closing is subject to customary conditions.

Overview of 2010 Performance

Total EBITDA for 2010 was \$21.2 million, a \$28.5 million improvement over the (\$7.3) million of EBITDA generated in 2009. For the year ended December 31, 2010, the distributable cash loss was \$6.8 million compared to a distributable cash loss of \$34.7 million for the year ended December 31, 2009.

Timberland Operations

Timberlands sales volume in 2010 was 3.0 million m³. This was 67% higher than the 2009 sales volume and was the highest sales volume achieved since 2006. The Company's private land harvest increased to 1.8 million m³ in 2010 from 1.2 million m³ in 2009, while its public land harvest increased to 740,000 m³ from 354,000 m³ in 2009. Higher harvest levels combined with additional log purchases were in response to strong demand from Asia. Volumes to China in 2010 increased 3.5 times over the previous year to a record 372,000 m³ while volumes to Korea increased 2.3 times to a record 238,000 m³. Volumes to Japan, at 852,000 m³ in 2010, increased 76% over the prior year. This was another sales volume record for the Company and made TimberWest the largest Canadian supplier of logs into that country.

The average sales realization in the fourth quarter was \$72 per m³ and \$73 per m³ for the year overall, an increase of \$3 per m³ over 2009. This increase was realized in spite of an 11% increase in the value of the Canadian dollar relative to its US counterpart. In 2010, the Canadian dollar averaged \$0.99 during the fourth quarter and \$0.97 for the year overall. Two thirds of total log revenue in 2010 were derived from transactions denominated in US dollars.

Average sales realizations in 2010 were constrained by the increased volume of lower value hemlock in the Company's sales mix. The incremental harvest in 2010 was focused heavily on hemlock, increasing hemlock's share of the total harvest mix by 20% over 2009. Hemlock represented 36% of the sales mix in 2010 while Douglas fir declined to 55% from 58% in 2009. While the average sales realization of hemlock in all markets was \$16 per m³ lower than the sales realization for fir in 2010, the price differential in China and Korea was much less significant. For sales to China and Korea in 2010, the average second growth fir realization was \$86 per m³ while the average second growth hemlock realization was \$85 per m³. The average hemlock sales realization in China and Korea increased 18% in 2010, from \$72 per m³ in 2009 to \$85 per m³ in 2010, despite the appreciation of the Canadian dollar.

The Company's various cost reduction programs and its sub-divided contractor model for timber harvesting operations demonstrated positive results at these higher harvest levels. The cost of sales in Q4, 2010 was \$63 per m³ and \$64 per m³ for the year overall. This compares to a cost of sales of \$71 per m³ in 2009.

While the Company did not celebrate its best year on record from a safety and environmental perspective, it had a very strong year on both fronts. The 2010 Medical Incident Rate of 0.6 was only slightly higher than the previous year at 0.5.

In terms of environmental stewardship, the Company was notified of two minor non-conformances, with no major non-conformances, when third party compliance audits were undertaken of the Company's environmental certifications during the year.

Management's Discussion & Analysis

Real Estate

The Company has established a real estate division which sells non-core, higher and better use, lands largely "as-is" while pursuing entitlement changes on its core development lands. The real estate division was formally branded during 2009 when the Company named the division "Couverdon."

For 2010, Couverdon sold fifteen properties for gross proceeds of \$13.0 million, or \$4,390 per acre. In 2009, Couverdon sold eight properties for gross proceeds of \$13.3 million, or \$3,803 per acre, and entered into two right-of-way agreements for proceeds of \$1.8 million.

The increase in per acre values compared to 2009 is attributable to the higher value mix of properties sold.

Summary

Results in 2010 were much improved. During 2010 TimberWest delivered four consecutive quarters of positive EBITDA. Total EBITDA for 2010 was \$21.2 million. This is a \$28.5 million improvement over the (\$7.3) million of EBITDA generated in 2009. The distributable cash loss for 2010 declined to \$6.8 million, a \$27.9 million improvement over the distributable cash loss of \$34.7 million for 2009.

Driving these improved results is increased demand and prices for fibre in Asia. Strong economic growth in China and Korea, improved market access, and a decline in Russian log supply, has provided a profitable and sustainable platform for TimberWest. 2010 marks the first year when more than half of the Company's log sales volumes were to the international markets.

The Company ended the year with improved liquidity and a stronger balance sheet. The May 2010 Stapled Unit offering generated \$56.8 million in net proceeds, all of which were applied to reduce the Company's operating credit facility. Net operating debt ended the year at \$103.0 million, an improvement of \$47.8 million from 2009 ending net operating debt levels of \$150.8 million. With improved liquidity, plus the improvements in profitability, the Company resumed paying the interest on its convertible debentures in cash in July.

In October 2010, TimberWest started paying the previously deferred Stapled Unit distributions. These payments were made in kind by issuing additional Stapled Units. The next payment in kind was made subsequent to year end in January, 2011. In April, 2011, the Company will pay deferred distributions in the amount of \$24.5 million by issuing additional Stapled Units. The Company will determine on a quarterly basis as to whether deferred distributions will be paid in cash or by the issuance of additional Stapled Units.

Management's Discussion & Analysis

Selected Annual Financial Information

(in millions of dollars except where otherwise noted)	2010	2009	2008
Sales	\$ 268.1	\$ 150.3	\$ 163.7
Operating earnings (loss) from continuing operations	16.7	(13.0)	(14.9)
EBITDA from continuing operations	21.2	(6.9)	(10.6)
EBITDA	21.2	(7.3)	(16.0)
Net earnings (loss) from continuing operations	(60.2)	(55.4)	240.7
Net loss from continuing operations excluding unusual items ¹	(23.2)	(0.8)	(101.3)
Net earnings (loss)	(60.2)	(55.8)	235.3
Net loss excluding unusual items ¹	(23.2)	(1.2)	(106.7)
Per common share – basic and diluted (in dollars)			
Net earnings (loss) from continuing operations	\$ (0.70)	\$ (0.71)	\$ 3.10
Net loss from continuing operations excluding unusual items ¹	(0.27)	(0.01)	(1.30)
Net earnings (loss)	(0.70)	(0.72)	3.03
Net loss excluding unusual items ¹	(0.27)	(0.02)	(1.37)
Total assets	\$ 1,275.9	\$ 1,264.4	\$ 1,300.2
Total long-term financial liabilities, excluding Series A Subordinate Notes	354.6	360.4	189.8
Interest payments on Series A Subordinate Notes held by unitholders			
Paid in cash	\$ -	\$ -	\$ 84.0
Paid in kind through the issuance of additional Stapled Units	3.5	-	-

1 Net loss from continuing operations excluding unusual items and net loss excluding unusual items are non-GAAP measures. Unusual items are defined as the following, net of their associated income tax impact: (i) gain on modification of Series A Subordinate Notes; (ii) accretion expense on the Series A Subordinate Notes; and (iii) change in fair value of financial instruments held for trading. These unusual items, net of their income tax impact, are quantified in the following table:

(in millions of dollars)	2010	2009	2008
Accretion expense on Series A Subordinate Notes	\$ (7.4)	\$ (6.6)	\$ -
Change in fair value of financial instruments held for trading	(31.5)	(54.4)	-
Gain on modification of Series A Subordinate Notes	-	-	461.6
Total unusual items	(38.9)	(61.0)	461.6
Income tax recognized on unusual items	1.9	6.4	(119.6)
Total unusual items, net of income tax	\$ (37.0)	\$ (54.6)	\$ 342.0
Total unusual items per common share – basic and diluted (in dollars)	\$ (0.43)	\$ (0.70)	\$ 4.40

2010 vs. 2009

Log revenues in 2010 of \$216.8 million were a \$91.1 million increase over the prior year. The volume sold during the year was 3.0 million m³; a 67% increase over 2009's volume of 1.8 million m³. Demand for fibre in the export markets led the recovery. Export sales volumes ended the year at 1.6 million m³; up 106% over 2009 volumes. Domestic sales of 1.4 million m³ comprised 47% of the total volume sold. Despite increases in US dollar pricing, a \$0.10 increase in the Canadian dollar held Canadian realizations in check. Sales realizations ended the year at \$73 per m³, a \$3 per m³ increase over 2009. Production for the year totaled 2.5 million m³ versus 1.5 million m³ harvested in 2009.

Real estate sales fell slightly from the prior year with sales of \$14.2 million in 2010 versus \$15.1 million in 2009.

Other sales in 2010 include \$31.0 million of revenue associated with TimberWest chartering its own vessels to ship to Asian markets. This revenue is a cost recovery of the amount incurred by TimberWest to charter these vessels.

Improved pricing combined with lower costs helped generate operating income of \$16.7 million in 2010. This was a \$29.7 million improvement over 2009's operating loss of \$13.0 million.

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Interest expense in 2010 was \$47.6 million, a \$4.7 million increase over 2009. The increase was a result of the convertible debentures being outstanding for a full year in 2010 versus 10.5 months in 2009, plus the additional 12,000,000 Series A Subordinated Notes that were issued as part of the May 12, 2010 Stapled Unit issuance. In 2010, no cash interest payments were made on the Series A Subordinate Notes. However, the Company did pay the April 15, 2009 deferred distribution on October 15, 2010 by the issuance of 885,447 Stapled Units. In 2009 no interest was paid by cash or in kind on the Series A Subordinate Notes. During 2010, the Company recognized interest expense, before accretion expense, on the Series A Subordinate notes of \$16.6 million and deferred payment of these distributions.

On the convertible debentures, the Company recorded interest expense of \$14.5 million in 2010. The Company paid \$7.2 million in cash and \$3.5 million was paid in kind by issuing additional convertible debentures with the balance accrued for at year end. For the year ended December 31, 2009 the Company recorded interest expense of \$11.9 million of which \$5.2 million was paid in cash, \$3.4 million was paid in kind by issuing convertible debentures, with the balance accrued for payment in kind on January 15, 2010 by issuing additional convertible debentures.

The Company generated a net loss before income taxes of \$65.2 million in 2010 compared to a \$117.5 million loss in 2009. Included in this loss were non cash changes to the fair value of financial instruments of \$31.5 million in 2010 versus non cash changes in fair value of \$54.4 million in 2009. The income tax recovery for 2010 was \$5.0 million versus a recovery of \$62.1 million in 2009. When the income tax recoveries are factored in, the net loss in 2010 was \$60.2 million versus \$55.8 million in 2009.

The Distributable cash loss in 2010 was \$6.8 million versus a loss of \$34.7 million in 2009.

The Company ended the year with improved liquidity and a stronger balance sheet, with net operating debt at \$103.0 million, an improvement of \$47.8 million from 2009.

The 2010 long-term debt, excluding the Series A Subordinate Notes, was \$354.6 million, which was comprised of \$106.5 million drawn on the revolving credit facility and convertible debentures with a fair market value of \$248.1 million. Comparatively, the 2009 revolving credit facility was \$152.6 million and convertible debentures had a fair value of \$207.8 million.

2009 vs. 2008

The balance sheet is stronger year over year due to improved liquidity as a result of \$150 million raised through the issuance of convertible debentures during 2009. The business used approximately \$33.5 million in cash during the year. Asset sales covered fixed operating costs and cash used to cover refinancing costs and cash interest obligations.

The decrease in total sales of \$13.4 million in 2009 was due to a decrease of \$21.7 million in log sales offset by increases of \$3.3 million in real estate sales and increases of \$5.0 million in other sales in 2009 compared to 2008. Average sales realizations and sales volumes for logs were lower in 2009 as a result of overall weak markets and the continuation of the Company's deferred harvest strategy on private lands. 2009 real estate sales included proceeds of \$1.8 million relating to two right-of-way agreements entered into during the year. Other sales in 2009 include \$4.5 million of revenue generated as a result of TimberWest chartering its own vessels to ship to Asian markets. This revenue is offset by costs associated with chartering ships. This was the first year TimberWest chartered its own vessels.

Continuing operations generated a net loss of \$0.8 million before unusual items in 2009 compared to a 2008 net loss of \$101.3 million. This variance is primarily the result of lower interest expense on the Series A Subordinate Notes due to the reduction of the per annum interest rate from 12% (fixed) to 2% (variable) that came into effect

Management's Discussion & Analysis

on December 31, 2008 and a future income tax recovery before unusual items of \$55.7 million in 2009 compared to a future income tax recovery before unusual items of \$5.1 million in 2008. 2009 net loss from continuing operations includes a change in fair value of financial instruments of \$54.4 million, financing transaction costs of \$5.5 million and a non-cash future income tax recovery of \$62.1 million. 2008 net earnings from continuing operations included restructuring costs of \$9.4 million and a non-cash future income tax expense of \$114.5 million. Including discontinued operations, the net loss for the year ended December 31, 2009 was \$55.8 million compared to net earnings of \$235.3 million for 2008.

The 2009 long-term debt, excluding the Series A Subordinate Notes, was \$306.0 million, which was comprised of \$152.6 million drawn on the long-term revolving credit facility and the issuance of the 9% five-year convertible debentures with a face value of \$153.4 million. Comparatively, the 2008 long-term debt was \$189.8 million drawn on the unsecured revolving facility. In 2009, no cash interest payments were made on the Series A Subordinate Note component of the Stapled Units held by unitholders as the payments were deferred commencing with the January 15, 2009 payment. In 2008, the interest payments on the Series A Subordinate Note were \$1.08 per Stapled Unit.

Management's Discussion & Analysis

Results of Operations

Timberlands

	2010	2009
Log sales (in millions of dollars)		
Domestic	\$ 77.7	\$ 56.9
Export – Asia	130.2	63.5
Export - USA	8.9	5.3
Total log sales	216.8	125.7
Freight and other sales	37.1	9.5
Total timberland sales	253.9	135.2
Log sales realizations (\$/m ³) - CAD		
Domestic	58	57
Export – Asia	89	91
Export - USA	59	60
Total log sales realizations - CAD	73	70
Log sales realizations (\$/m ³) – USD		
Domestic	55	48
Export – Asia	86	80
Export - USA	57	51
Total log sales realizations - USD	71	61
Log sales volume (million m ³)		
Domestic	1.4	1.0
Export – Asia	1.5	0.7
Export - USA	0.1	0.1
Total log sales volume	3.0	1.8
Log sales mix (million m ³)		
Fir	1.6	1.0
Hembal	1.1	0.5
Cedar	0.2	0.1
Other	0.1	0.2
Total log sales mix	3.0	1.8
Log production volume (million m ³)		
Public tenures	0.7	0.3
Private timberlands	1.8	1.2
Total production volume	2.5	1.5
Log production costs (\$/m ³)	63	70
Timberland cost of sales (\$/m ³)	64	71
Timberland operating margin (% of log sales)	12%	(2)%

Log sales increased by \$91.1 million to \$216.8 million due to a 67% increase in volume sold and a \$3 per m³ increase in average log realizations. Pricing improved across all markets as evidenced by the increase in USD realizations, in aggregate, from \$61 USD to \$71 USD per m³. However, the increase in USD prices was offset by a stronger Canadian dollar. The Canadian dollar averaged \$0.97 in 2010 compared to \$0.87 in 2009.

Timberland operations generated other sales of \$37.1 million in 2010, compared to \$9.5 million in 2009. Other sales in 2010 include \$31.0 million of revenue generated as a result of TimberWest chartering its own vessels to ship to Asian markets (2009 - \$4.5 million).

Management's Discussion & Analysis

Unit log production costs decreased in 2010 as fixed costs were absorbed over a higher harvest volume. This year the Company produced 1.8 million m³ from its private lands and 0.7 million m³ from its public lands for a total harvest of 2.5 million m³, compared to 1.2 million m³ and 0.3 million m³ in 2009, respectively. Timberland unit costs were lower by \$7 per m³ in 2010 with logging production costs for the year of \$63 per m³ compared to \$70 per m³ in the prior year. Logging production volumes for 2010 were up 67% from 2009, to 2.5 million m³.

The operating margin for 2010 was 12%, up from negative 2% for 2009, reflecting the effects of higher log sales realizations, higher production volumes and increased sales volumes.

Real Estate

(in millions of dollars except where otherwise noted)	2010	2009
Sales	\$ 14.2	\$ 15.1
Price per acre (\$/acre)	4,390	3,803

For 2010, Couverdon sold fifteen properties for gross proceeds of \$13.0 million, or \$4,390 per acre and generated other revenue of \$1.2 million. In 2009, Couverdon sold eight properties for gross proceeds of \$13.3 million, or \$3,803 per acre, and entered into two right-of-way agreements for proceeds of \$1.8 million.

The increase in per acre values compared to 2009 is attributable to the higher value mix of properties sold.

During the year, costs of \$3.4 million were deferred related to entitlement and planning activities (2009 - \$0.8 million).

Real estate sales generally vary from year to year reflecting the variable nature and timing of real estate sales activity.

EBITDA

The following table details the calculation of TimberWest's earnings (loss) from continuing operations before interest, taxes, depreciation and amortization ("EBITDA") for both fiscal 2010 and 2009.

(in millions of dollars)	2010	2009
Net earnings (loss) from continuing operations	\$ (60.2)	\$ (55.4)
Add (deduct):		
Interest on Series A Subordinate Notes owned by unitholders	16.6	14.2
Interest on convertible debentures	14.5	11.9
Interest on long-term bank debt	9.1	9.7
Interest on short-term bank debt	-	0.5
Income tax expense (recovery)	(5.0)	(62.1)
Depreciation, depletion and amortization	4.3	4.4
Amortization of deferred financing costs	2.8	1.9
Accretion on Series A Subordinate Notes	7.4	6.6
Change in fair value of financial instruments held for trading	31.5	54.4
Change in fair value of Stapled Unit option plan	0.2	1.5
Financing transaction costs	-	5.5
EBITDA from continuing operations	21.2	(6.9)
EBITDA from discontinued operations ¹	-	(0.4)
EBITDA	\$ 21.2	\$ (7.3)

1 The Company permanently closed its Elk Falls sawmill operations on May 9, 2008.

Management's Discussion & Analysis

EBITDA from continuing operations for the year ended December 31, 2010, increased to \$21.2 million, compared to \$(6.9) million for 2009. On a per weighted average Stapled Unit basis, EBITDA from continuing operations increased to \$0.25 for 2010, from \$(0.09) in the prior year. For the year ended December 31, 2010, EBITDA from continuing operations as a percentage of sales increased to 8%, up from (5)% for the year ended December 31, 2009. EBITDA for the year ended December 31, 2010 increased to \$21.2 million, compared to \$(7.3) million for 2009. On a per weighted average Stapled Unit basis EBITDA increased to \$0.25 for 2010 from \$(0.09) for 2009.

Income Taxes

The Company reported an income tax recovery of \$5.0 million for the year ended December 31, 2010, compared to an income tax recovery of \$62.1 million for 2009.

The \$5.0 million income tax recovery for 2010 includes a \$4.5 million non-cash future income tax recovery. The non-cash future income tax recovery is primarily the result of the estimated net tax losses generated in the year and the Company's internal capital reorganization related to the amalgamation of a 100% owned subsidiary undertaken in the first quarter.

The \$62.1 million income tax recovery for 2009 is a non-cash future income tax recovery and includes a \$63.3 million non-cash future income tax recovery relating to the recognition of previously unrecognized non-capital losses and tax planning activities. Due to changes in the Income Tax Act of Canada, non-capital losses can be carried forward for 20 years, and as such, the Company recognized the benefit of the non-capital loss carry forward extension in 2009. Included in the 2009 future income tax recovery is a recovery of \$3.5 million from the reduction of the British Columbia provincial corporate tax rate to 10.5% for the year ending December 31, 2010 and 10% thereafter and a \$3.9 million future income tax expense from expiration of non-capital tax losses.

The Company reduced its valuation allowance for prior year losses in 2009 as the Company had identified tax planning activities to utilize these losses against taxable temporary difference relating to private timberlands.

Finance Charges

Interest expense for the year ended December 31, 2010, was \$47.6 million, a \$4.7 million increase over the prior year. This increase is the result of additional debt levels resulting from more Series A Subordinate notes that were issued through the public offering, interest paid in kind on the Subordinate Notes, Stapled Unit options exercised, and additional convertible debentures that were issued as payment in kind. Interest on bank debt decreased by \$1.1 million compared to the prior year primarily due to the reduction in the balance outstanding on the credit facility as a result of the public Stapled Unit offering in 2010.

Included in interest expense is \$7.4 million of accretion expense (2009 - \$6.6 million) recognized on the Series A Subordinate Notes. The Company has measured the Series A Subordinate Notes at amortized cost and therefore accounts for this financial instrument using the effective interest method.

Amendments made to the Series A Subordinate Notes on December 19, 2008, resulted in a change to the interest rate from a fixed 12% to a variable rate between 2% and 12%. The Company set its interest rate on the Series A Subordinate Notes for 2009 and 2010 at 2%. Interest distributions, at face value, to unitholders on the Series A Subordinate Notes were \$15.6 million in 2010 compared to \$14.0 million in 2009. The Company has elected to defer payment of its interest obligations for up to 18 months, and as a result the deferred distribution payable is accounted for at its fair value. As a result of this valuation, interest expense recognized with respect to the distributions to unitholders is \$16.6 million (2009 - \$14.2 million).

The Company issued 9% five-year convertible debentures with a face value of \$150 million in February 2009. Interest expense on the convertible debentures for 2010 was \$14.5 million (2009 - \$11.9 million). During 2010 the

Management's Discussion & Analysis

Company paid interest of \$7.2 million in cash and \$3.5 million in kind by issuing convertible debentures with balance accrued for at year end. During 2009, the Company paid interest of \$5.2 million in cash and \$3.4 million in kind by issuing convertible debentures, with the balance accrued for payment in kind on January 15, 2010 by issuing additional debentures.

The amortization of debt issue costs was \$2.8 million for the year ended December 31, 2010, an increase from the \$1.9 million for the year ended December 31, 2009. The current provision reflects the deferral and amortization of fees incurred in connection with the new credit facility committed to in 2009.

Management's Discussion & Analysis

Net Earnings (Loss)

The following table presents the results of TimberWest's operations for the year ended December 31, 2010, in comparison to the results for the years ended December 31, 2006 through December 31, 2009.

Consolidated Statements of Operations

(in millions of dollars except where otherwise noted)

	2010	2009	2008	2007	2006
Sales	\$ 268.1	\$ 150.3	\$ 163.7	\$ 318.4	\$ 344.7
Operating costs and expenses:					
Cost of sales	235.5	147.0	161.6	239.4	238.8
Selling, administrative and other	11.6	11.9	12.5	16.1	13.2
Depreciation, depletion and amortization	4.3	4.4	4.5	5.4	5.7
	251.4	163.3	178.6	260.9	257.7
Operating earnings (loss) from continuing operations	16.7	(13.0)	(14.9)	57.5	87.0
Interest expense:					
Series A Subordinate Notes owned by unitholders	24.0	20.8	80.8	83.7	83.6
Convertible debentures	14.5	11.9	-	-	-
Long-term debt	9.1	9.7	7.6	3.7	11.2
Short-term debt	-	0.5	2.6	11.2	3.4
	47.6	42.9	91.0	98.6	98.2
Amortization of debt issue costs	2.8	1.9	0.3	0.9	0.6
Other (income) expense, net	-	(0.2)	0.2	(6.5)	(0.7)
Change in fair value of financial instruments held for trading	31.5	54.4	-	-	-
Financing transaction fees	-	5.5	-	-	-
Gain on modification of Series A Subordinate Notes	-	-	(461.6)	-	-
Pension plan annuitization	-	-	-	-	17.7
	81.9	104.5	(370.1)	93.0	115.8
Earnings (loss) before income taxes from continuing operations	(65.2)	(117.5)	355.2	(35.5)	(28.8)
Income tax expense (recovery)	(5.0)	(62.1)	114.5	(22.2)	(38.2)
Net earnings (loss) from continuing operations	(60.2)	(55.4)	240.7	(13.3)	9.4
Net earnings (loss) from discontinued operations	-	(0.4)	(5.4)	(18.5)	7.7
Net earnings (loss)	(60.2)	(55.8)	235.3	(31.8)	17.1
Net earnings (loss) excluding unusual items ¹	(23.2)	(1.2)	(106.7)	(31.8)	17.1
Per common share – basic and diluted (in dollars)					
Net earnings (loss) from continuing operations	\$ (0.70)	\$ (0.71)	\$ 3.10	\$ (0.17)	\$ 0.12
Net earnings (loss) from discontinued operations	-	(0.01)	(0.07)	(0.24)	0.10
Net earnings (loss)	(0.70)	(0.72)	3.03	(0.41)	0.22
Net earnings (loss) excluding unusual items ¹	(0.27)	(0.02)	(1.37)	(0.41)	0.22

1 Net earnings (loss) from continuing operations excluding unusual items and net earnings (loss) excluding unusual items are non-GAAP measures. Unusual items are defined as the following, net of their associated income tax impact: (i) gain on modification of Series A Subordinate Notes; (ii) accretion expense on the Series A Subordinate Notes; and, (iii) change in fair value of financial instruments held for trading. These unusual items, net of their income tax impact, are quantified in the following table:

Management's Discussion & Analysis

(in millions of dollars)	2010	2009	2008	2007	2006
Accretion expense on Series A Subordinate Notes	\$ (7.4)	\$ (6.6)	\$ -	\$ -	\$ -
Change in fair value of financial instruments held for trading	(31.5)	(54.4)	-	-	-
Gain on modification of Series A Subordinate Notes	-	-	461.6	-	-
Total unusual items	(38.9)	(61.0)	461.6	-	-
Income tax recognized on unusual items	1.9	6.4	(119.6)	-	-
Total unusual items, net of income tax	\$ (37.0)	\$ (54.6)	\$ 342.0	\$ -	\$ -
Total unusual items per common share – basic and diluted (in dollars)	\$ (0.43)	\$ (0.70)	\$ 4.40	\$ -	\$ -

The operating income from continuing operations for the year ended December 31, 2010, was \$16.7 million compared to a loss of \$13.0 million in 2009. The year-over-year improvement in operating earnings from continuing operations reflects the \$117.8 million increase in sales primarily as a result of higher log sales in 2010 over 2009.

Distributable Cash

The following table presents distributable cash generated by TimberWest for the year ended December 31, 2010, in comparison to distributable cash generated for the years ended December 31, 2006 through December 31, 2009.

Consolidated Statements of Distributable Cash

(in millions of dollars except where otherwise noted)	2010	2009	2008	2007	2006
Net earnings (loss) from continuing operations	\$ (60.2)	\$ (55.4)	\$ 240.7	\$ (13.3)	\$ 9.4
Interest on Series A Subordinate Notes owned by unitholders	16.6	14.2	80.8	83.7	83.6
Earnings (loss) from continuing operations available for distribution	(43.6)	(41.2)	321.5	70.4	93.0
Accretion on Series A Subordinate Notes	7.4	6.6	-	-	-
Change in fair value of financial instruments held for trading	31.5	54.4	-	-	-
Future income tax expense (recovery)	(4.5)	(62.1)	114.5	(22.1)	(38.2)
Gain on modification of Series A Subordinate Notes	-	-	(461.6)	-	-
Earnings (loss) available from continuing operations available for distribution before accretion, changes in fair value of financial instruments held for trading, gain on modification of Series A Subordinate Notes and provision for future income taxes	(9.2)	(42.3)	(25.6)	48.3	54.8
Add (deduct):					
Depreciation, depletion and amortization	7.1	6.3	4.8	6.3	6.3
Proceeds from sale of property, plant and equipment	12.6	12.8	11.5	71.9	33.0
Gain on sale of property, plant and equipment	(6.7)	(5.7)	(5.5)	(28.5)	(14.9)
Additions to property, plant and equipment	(6.9)	(1.3)	(2.1)	(3.4)	(4.3)
Financing costs	(3.2)	(5.9)	(2.0)	-	-
Other non-cash items	(0.5)	1.8	1.8	(1.6)	18.7
	2.4	8.0	8.5	44.7	38.8
Distributable cash from continuing operations	(6.8)	(34.3)	(17.1)	93.0	93.6
Distributable cash from discontinued operations	-	(0.4)	(7.7)	(2.7)	10.2
Distributable cash	\$ (6.8)	\$ (34.7)	\$ (24.8)	\$ 90.3	\$ 103.8

Management's Discussion & Analysis

Consolidated Statements of Distributable Cash

(in millions of dollars except where otherwise noted)

	2010	2009	2008	2007	2006
Reconciliation of cash flows from continuing operations to distributable cash:					
Cash flow from continuing operations	\$ (14.6)	\$ (36.7)	\$ (94.4)	\$ (68.7)	\$ (1.4)
Add (deduct):					
Change in non-cash working capital	13.3	0.2	(13.7)	9.3	(17.3)
Interest on Series A Subordinate Notes owned by unitholders	16.6	14.2	80.8	83.7	83.6
Proceeds from sale of property, plant and equipment	12.6	12.8	11.5	71.9	33.0
Additions to property, plant and equipment	(6.9)	(1.3)	(2.1)	(3.4)	(4.3)
Financing costs	(3.2)	(5.9)	(2.0)	-	-
Change in deferred distribution payable	(16.6)	(14.3)	-	-	-
Convertible debenture interest paid in kind	(7.0)	(3.4)	-	-	-
Other non-cash items	(1.0)	0.1	2.8	0.2	-
Cash flow from (used in) discontinued operations	-	(0.4)	(7.7)	(2.7)	10.2
Distributable Cash	\$ (6.8)	\$ (34.7)	\$ (24.8)	\$ 90.3	\$ 103.8
Per Stapled Unit – basic and diluted					
Earnings (loss) available from continuing operations available for distribution before accretion, changes in fair value of financial instruments held for trading, gain on modification of Series A Subordinate Notes and provision for future income taxes	\$ (0.11)	\$ (0.54)	\$ (0.33)	\$ 0.62	\$ 0.71
Distributable cash from continuing operations	(0.08)	(0.44)	(0.22)	1.20	1.21
Distributable cash from discontinued operations	-	(0.01)	(0.10)	(0.04)	0.13
Distributable cash	(0.08)	(0.45)	(0.32)	1.16	1.34
Cash distributions paid	\$ -	\$ -	\$ 1.08	\$ 1.08	\$ 1.08
Distributions paid by issuance of additional Stapled Units	0.04	-	-	-	-
Basic weighted average number of Stapled Units outstanding (000's)	85,554	77,772	77,759	77,720	77,545
Diluted weighted average number of Stapled Units outstanding (000's)	86,024	77,999	77,782	77,848	77,618
Stapled Units outstanding at the end of the period (000's)	90,831	77,777	77,765	77,750	77,635

Distributable cash includes consolidated net earnings (loss), plus interest expensed on Series A Subordinate Notes owned by unitholders, plus non-cash items including income taxes, changes in fair values and accretion expense, 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, less financing costs and, from time to time, adjustments for other items deemed appropriate by the Board of Directors.

Earnings from continuing operations available for distribution is comprised of consolidated net earnings (loss) from continuing operations plus interest expensed on Series A Subordinate Notes. The Series A Subordinate Notes are owned by the unitholders and interest thereon is paid to the unitholders, therefore, earnings from continuing operations available for distribution to unitholders reflects earnings before this interest charge.

Earnings from continuing operations available for distribution and distributable cash are measures that do not have a standardized meaning prescribed by Canadian 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 (loss) and cash flow from continuing operations before changes in working capital, as determined in accordance with Canadian

Management's Discussion & Analysis

GAAP, and earnings from continuing operations available for distribution and distributable cash are provided in the preceding tables.

Sensitivity Analysis

Markets for TimberWest's products are cyclical and affected by such factors as economic growth, interest rates, foreign exchange rates, ocean freight rates, residential construction activity and international competition. TimberWest's earnings are subject to variations 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 (65% of revenue in 2010), all 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 Japanese Yen and other currencies also affect the Company's competitiveness in the markets where it sells its products. The Company does not hedge its foreign exchange risk. 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 (loss) from continuing operations to changes in the average Canadian dollar selling price and volumes sold for its major products and in the value of the Canadian dollar relative to the US dollar. These sensitivities have limitations in that they imply all other variables remain constant. However, they are a useful approximation in their relative impact of these changes on operating earnings.

(in millions of dollars)	Effect on operating earnings
Logs – \$5 change per m ³	\$ 12.5
Canadian dollar – \$0.01 US change per Canadian dollar ¹	1.4

1 Estimate is based on US-dollar denominated sales for the year ending December 31, 2010, assuming all other variables remain constant.

Financial Condition

The following table presents summary information on TimberWest's financial position as at December 31, 2010 in comparison to balances as at December 31, 2009.

(in millions of dollars)	2010	2009
Cash and cash equivalents	\$ 3.5	\$ 1.8
Current assets, excluding cash and cash equivalents	52.1	37.6
Property, plant & equipment	1,209.7	1,213.0
Other assets	10.6	12.0
Total assets	1,275.9	1,264.4
Current liabilities	58.0	27.2
Long-term financial liabilities	354.6	360.4
Other long-term liabilities	219.8	241.5
Discontinued operations	-	0.2
	632.4	629.3
Series A Subordinate Notes owned by unitholders	315.1	247.1
	947.5	876.4
Unitholders' equity	328.4	388.0
Total liabilities and unitholders' equity	\$ 1,275.9	\$ 1,264.4

Management's Discussion & Analysis

The following table highlights the significant changes between the consolidated balance sheets as at December 31, 2010 and December 31, 2009.

(in millions of dollars)	2010	2009	Increase / (decrease)	
Cash and cash equivalents	\$ 3.5	\$ 1.8	\$ 1.7	The increase in cash is primarily the result of timing of cash receipts at period end. Refer to section "Liquidity and Capital Resources" for greater detail.
Current assets, excluding cash and cash equivalents	52.1	37.6	14.5	The increase is primarily due to an increase in log inventory, combined with increases in accounts receivables and prepaids and others assets.
Property, plant & equipment	1,209.7	1,213.0	(3.3)	The decrease is due to the sale of fifteen real estate properties and depreciation recorded in the period, offset by additional capitalized development costs and fixed asset additions made during the year.
Other assets	10.6	12.0	(1.4)	The decrease is due to the amortization of capitalized financing costs associated with the restructuring of the Company's revolving credit facility and offset by the change in fair value of the financial instruments held for trading and increases in other receivables.
Current liabilities	58.0	27.2	30.8	The increase is primarily due to deferred distributions on the Series A Subordinate notes coming due in 2011, which increased the current liability balance by \$30.8 million over the prior year. Accounts payable and accrued liabilities remained the same year over year.
Credit facilities	106.5	152.6	(46.1)	The decrease is due to funds received from the Stapled Unit issuance enabling the Company to pay down its revolving credit facility.
Convertible debentures	248.1	207.8	40.3	The increase is due to changes in fair value and the issuance of convertible debentures in 2010 as a result of paying \$7.0 million (face value) payments in kind. The face value of the convertible debentures is \$160.3 million at December 31, 2010.
Other long-term liabilities	219.8	241.5	(21.7)	The decrease is primarily due to a \$17.7 million decrease in the deferred distributions payable on the Series A Subordinate notes as the 2011 obligations are classified as current and a \$4.2 million reduction in the future income tax liability.
Series A Subordinate Notes owned by unitholders	315.1	247.1	68.0	The increase is primarily due to the \$60.0 million Stapled Unit issuance and recognition of accretion during the year.
Unitholders' equity	328.4	388.0	(59.6)	The decrease is due to the net loss for the year; offset in part by the increase in common shares issued as a result of the Stapled Unit issuance.

Management's Discussion & Analysis

Liquidity and Capital Resources

Selected Annual Financial Information

(in millions of dollars except where otherwise noted)	2010	2009
Cash provided by (used in):		
Operating activities from continuing operations	(14.6)	(36.7)
Financing activities	11.2	(1.4)
Investing activities	5.1	10.7
Cash provided by (used in) discontinued operations	-	(1.6)
Increase (decrease) in cash and cash equivalents	1.7	(29.0)
Consolidated debt-to-total capitalization ratio ¹	11:89	15:85

1 The consolidated debt-to-total capitalization ratio does not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Debt includes the senior debt held by a syndicate of banks. Management believes that the presentation of these measures will enhance an investor's understanding of the Company's operating performance.

The Company's primary cash requirements as the industry begins to recover are to fund operations, capital expenditures and interest payments on the Company's debt and equity instruments. The Company continues to benefit from steps taken in the past few years to reduce cash outlays, such as the closing of its last remaining sawmill in May 2008, decreasing the number of employees from 297 at the end of 2008 to 80 at the end of 2010, restructuring its contractor arrangements, changing to a variable interest rate on the Series A Subordinate Notes and deferring interest payments on these notes. The Company will determine on a quarterly basis as to whether deferred distributions will be paid in cash or by the issuance of additional Stapled Units.

Operating

Cash used in continuing operating activities for 2010 and 2009 was \$14.6 million and \$36.7 million, respectively. No distributions were paid to unitholders in cash in 2010 or 2009. The deferred distribution originally payable on April 15, 2009 but deferred for 18 months was paid in kind on October 15, 2010 by issuance of 885,447 Stapled Units. The deferred distribution originally payable on July 15, 2009 but deferred for 18 months was paid in kind on January 17, 2011 by issuance of 785,854 Stapled Units.

The Company recommenced paying its convertible debenture interest with cash starting with the July 15, 2010 payment for total cash payments of \$7.2 million during 2010 (2009 - \$5.2 million). Interest payments on the convertible debentures were paid in kind from the October 15, 2009 payment to the April 15, 2010 payment by issuing convertible debentures with a face value of \$7.0 million in 2010 and \$3.4 million in 2009.

Financing Activities

Cash provided by financing activities was \$11.2 million for the year ended December 31, 2010, compared to \$1.4 million used in financing activities for the year ended December 31, 2009.

In 2010, the Company raised \$60.0 million through a public Stapled Unit offering consisting of 12,000,000 Stapled Units at a price of \$5.00 per Stapled Unit. Transaction costs associated with the offering were \$3.2 million. Proceeds from the offering were applied to the Company's operating revolving credit facility.

In 2009 the Company issued convertible debentures for cash proceeds of \$150.0 million, of which \$75.0 million was used to permanently pay down the credit facility, with the remainder reducing indebtedness under the revolving credit facility and to fund company operations. The Company has the option to pay the interest on these convertible debentures in kind in order to preserve liquidity.

Management's Discussion & Analysis

In February 2009, the Company completed a new three-year secured revolving credit refinancing arrangement and in October 2009, the Company completed amendments to the bank loan agreement with its syndicate of banks which resulted in the Company having access to \$220.0 million in this revolving credit facility.

2009 transaction costs associated with the refinancing were \$11.4 million; \$5.5 million was expensed against income as it relates to the convertible debentures, which have been designated as held for trading and \$5.9 million was deferred and capitalized on the balance sheet as these costs relate to debt refinancing held at amortized cost.

In 2010, 155,681 Stapled Units were issued on the exercise of Stapled Units options for net proceeds of \$0.5 million. No Stapled Units were issued in 2009 as a result of the exercise of Stapled Unit options.

During 2010, the Company decreased its overall borrowings by \$39.2 million by decreasing the borrowings on its credit facility by \$46.1 million, the conversion of \$0.1 million convertible debentures into Stapled Units offset by issuing convertible debentures with a face value of \$7.0 million, as the Company paid the interest on convertible debentures in kind.

During 2009, the Company increased its overall borrowings by \$7.9 million by issuing convertible debentures with a face value of \$153.4 million and decreasing the borrowings on its credit facilities by \$145.5 million.

Cash and cash equivalents at the end of 2010 were \$3.5 million compared to \$1.8 million in the prior year. The Company's consolidated debt-to-total capitalization ratio as at December 31, 2010 was 11:89 compared to 15:85 at December 31, 2009.

Investing Activities

Cash provided by investing activities was \$5.1 million for the year ended December 31, 2010, compared to \$10.7 million for the year ended December 31, 2009.

Net proceeds from the sale of real estate properties during fiscal 2010 were \$12.6 million, compared to \$12.8 million for the prior year.

Additions to property, plant and equipment for the year ended December 31, 2010 were \$6.9 million, compared to \$1.3 million for 2009. 2010 capital additions include \$3.4 million in deferred real estate entitlement and planning costs (2009 - \$0.8 million), \$2.0 million for buildings and infrastructure (2009 - nil), and \$1.3 million for timberland operations road building activities (2009 - \$0.2 million), and \$0.2 million for other information management systems (2009 - \$0.1 million).

Changes in other assets resulted in net cash outflows of \$0.6 million during 2010 and \$0.8 million in 2009. Other assets include several balances, many of which are non-cash items, including deferred financing costs.

Management's Discussion & Analysis

Capital Resources

The Company's capital resources at December 31, 2010 include amounts available under the revolving credit facility. This source of borrowing, coupled with cash from operations, are expected to be sufficient to support the Company's working capital requirements and to finance planned capital expenditures during 2011. Credit ratings for the Company have been confirmed by Dominion Bond Rating service at BBB in 2010. Available capital resources and total liquidity at year-end is summarized in the following table:

(in millions of dollars)	2010	2009
Borrowing base		
Revolving credit facility (due February 11, 2012)	\$ 220.0	\$ 220.0
Less Letters of credit	14.5	16.4
Amount drawn	106.5	152.6
Available to be drawn	99.0	51.0
Cash on hand	3.5	1.8
Total liquidity	\$ 102.5	\$ 52.8

At December 31, 2010, the total debt calculated for financial reporting purposes was \$354.6 million. The following table outlines the changes in the Company's long-term debt for the year ended December 31, 2010:

(in millions of dollars)	2009	Net increase (decrease)	2010
Secured revolving credit facility of up to \$230.0 ¹ million due February 11, 2012 with interest based on Canadian or U.S. Prime rates + 5%, or Canadian BA rates + 6%	\$ 152.6	(46.1)	\$ 106.5
Convertible debentures with a face value of \$160.3 million as of December 31, 2010, due February 11, 2014 ²	207.8	40.3	248.1
Total long-term debt	360.4	(5.8)	354.6

- 1 The secured, revolving facility will increase from \$220.0 million to \$230.0 million beginning January 1, 2011 provided certain EBITDA levels are achieved, otherwise it will reduce to \$215.0 million of available capacity.
- 2 The convertible debentures are designated as "held-for-trading" for accounting purposes and as such are valued at fair value. The face value of convertible debentures outstanding at December 31, 2010 is \$160.3 million (2009 - \$153.4 million). The increase in fair value is recognized on the consolidated statement of operations and comprehensive income (loss).

Refer to the Company's consolidated financial statements for the year ended December 31, 2010, note 12 for details related to covenant compliance. The Company is in compliance with its covenants as at December 31, 2010.

The Company expects to meet its future cash requirements through a combination of cash generated from its timberland operations and real estate sales, existing cash balances and the revolving credit facility.

Management's Discussion & Analysis

The Company's continuation as a going concern is ultimately dependent upon its future financial performance, which will be affected by general economic, competitive and other factors, many of which are beyond the Company's control. In the short term, any significant strengthening of the Canadian dollar, or further decline in U.S. housing and Vancouver Island real estate markets which affects demand or other unexpected adverse developments could adversely impact the Company's liquidity.

Future Financial Commitments

As disclosed in note 18 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, 2010, commitments not reflected in the Company's consolidated balance sheets amounted to \$18.5 million.

The following table provides a summary of the Company's future financial commitments as at December 31, 2010. 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.

(in millions of dollars)	2011	2012	2013	2014	2015	2016+	Total
Reflected on the consolidated balance sheets:							
Revolving credit facilities	\$ -	\$ 106.5	\$ -	\$ -	\$ -	\$ -	\$ 106.5
Convertible debentures	-	-	-	160.3	-	-	160.3
Deferred distributions on the Series A Subordinate Notes ¹	35.0	12.1	-	-	-	-	47.1
	35.0	118.6	-	160.3	-	-	313.9
Not reflected on the consolidated balance sheets:							
Obligations under operating leases	0.7	0.6	0.6	0.3	0.3	1.5	4.0
Outstanding letters of credit ²	14.5	-	-	-	-	-	14.5
	15.2	0.6	0.6	0.3	0.3	1.5	18.5
	\$ 50.2	\$ 119.2	\$ 0.6	\$ 160.6	\$ 0.3	\$ 1.5	\$ 332.4

1 Deferred distributions payable to unitholders are shown here at face value, whereas they are recorded at their fair value on the consolidated balance sheets.

2 Letters of credit are committed in perpetuity, renew annually and the liability will diminish over time.

Off-Balance Sheet Arrangements

TimberWest has no stand alone or equity issued 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. There are embedded derivatives within the Company's Series A Subordinate Notes contract and the Company has recorded these at fair value. 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

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.

Summary of Quarterly Results

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. In the Company's opinion, the amounts include all normal recurring adjustments necessary for the fair presentation of such information. These financial results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

Unaudited (in millions of dollars except per common share and per Stapled Unit amounts)	2010					2009				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
Sales	\$ 58.7	\$ 80.9	\$ 65.9	\$ 62.6	\$ 268.1	\$ 30.4	\$ 38.0	\$ 37.5	\$ 44.4	\$ 150.3
Operating earnings (loss) from continuing operations	\$ 2.0	\$ 8.8	\$ 1.6	\$ 4.3	\$ 16.7	\$ (3.1)	\$ (4.6)	\$ (2.2)	\$ (3.1)	\$ (13.0)
Net earnings (loss) from continuing operations	\$ (24.7)	\$ 17.1	\$ 0.6	\$ (53.2)	\$ (60.2)	\$ (7.6)	\$ (30.2)	\$ (25.9)	\$ 8.3	\$ (55.4)
Net earnings (loss) from discontinued operations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.1)	\$ (0.1)	\$ (0.1)	\$ (0.1)	\$ (0.4)
Net earnings (loss)	\$ (24.7)	\$ 17.1	\$ 0.6	\$ (53.2)	\$ (60.2)	\$ (7.7)	\$ (30.3)	\$ (26.0)	\$ 8.2	\$ (55.8)
Earnings (loss) from continuing operations available for distribution ¹	\$ (21.0)	\$ 21.3	\$ 4.9	\$ (48.8)	\$ (43.6)	\$ (4.2)	\$ (26.7)	\$ (22.3)	\$ 12.0	\$ (41.2)
Earnings (loss) from continuing operations available for distribution before accretion expense, change in fair value of financial instruments held for trading and provision for future income tax expense (recovery) ¹	\$ (4.7)	\$ 2.4	\$ (4.6)	\$ (2.3)	\$ (9.2)	\$ (13.4)	\$ (11.0)	\$ (8.3)	\$ (9.6)	\$ (42.3)
Distributable cash from continuing operations ¹	\$ (2.9)	\$ 4.0	\$ (4.7)	\$ (3.2)	\$ (6.8)	\$ (15.2)	\$ (5.3)	\$ (3.7)	\$ (10.1)	\$ (34.3)
Distributable cash from discontinued operations ¹	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.1)	\$ (0.1)	\$ (0.1)	\$ (0.1)	\$ (0.4)
Distributable cash ¹	\$ (2.9)	\$ 4.0	\$ (4.7)	\$ (3.2)	\$ (6.8)	\$ (15.3)	\$ (5.4)	\$ (3.8)	\$ (10.2)	\$ (34.7)
Distributions paid ⁴	\$ -	\$ -	\$ -	\$ 3.5	\$ 3.5	\$ -	\$ -	\$ -	\$ -	\$ -

Management's Discussion & Analysis

Unaudited (in millions of dollars except per common share and per Stapled Unit amounts)	2010					2009				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
\$ per common share² – basic										
Net earnings (loss) from continuing operations	\$ (0.32)	\$ 0.20	\$ 0.01	\$ (0.59)	\$ (0.70)	\$ (0.10)	\$ (0.39)	\$ (0.33)	\$ 0.11	\$ (0.71)
Net earnings (loss) from discontinued operations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.01)	\$ (0.01)
Net earnings (loss)	\$ (0.32)	\$ 0.20	\$ 0.01	\$ (0.59)	\$ (0.70)	\$ (0.10)	\$ (0.39)	\$ (0.33)	\$ 0.10	\$ (0.72)
\$ per common share² – diluted										
Net earnings (loss) from continuing operations	\$ (0.32)	\$ 0.14	\$ 0.01	\$ (0.58)	\$ (0.70)	\$ (0.10)	\$ (0.39)	\$ (0.33)	\$ 0.07	\$ (0.71)
Net earnings (loss) from discontinued operations	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.01)
Net earnings (loss)	\$ (0.32)	\$ 0.14	\$ 0.01	\$ (0.58)	\$ (0.70)	\$ (0.10)	\$ (0.39)	\$ (0.33)	\$ 0.07	\$ (0.72)
\$ per Stapled Unit² – basic										
Earnings (loss) from continuing operations available for distribution ¹	\$ (0.27)	\$ 0.25	\$ 0.05	\$ (0.54)	\$ (0.51)	\$ (0.05)	\$ (0.34)	\$ (0.29)	\$ 0.15	\$ (0.53)
Earnings (loss) from continuing operations available for distribution before accretion expense, change in fair value of financial instruments held for trading and provision for future income tax expense (recovery) ¹	\$ (0.06)	\$ 0.03	\$ (0.05)	\$ (0.03)	\$ (0.11)	\$ (0.17)	\$ (0.14)	\$ (0.11)	\$ (0.12)	\$ (0.54)
Distributable cash from continuing operations ¹	\$ (0.04)	\$ 0.05	\$ (0.05)	\$ (0.04)	\$ (0.08)	\$ (0.20)	\$ (0.07)	\$ (0.05)	\$ (0.13)	\$ (0.44)
Distributable cash from discontinued operations ¹	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.01)
Distributable cash ¹	\$ (0.04)	\$ 0.05	\$ (0.05)	\$ (0.04)	\$ (0.08)	\$ (0.20)	\$ (0.07)	\$ (0.05)	\$ (0.13)	\$ (0.45)
Distributions paid ⁴	\$ -	\$ -	\$ -	\$ 0.04	\$ 0.04	\$ -	\$ -	\$ -	\$ -	\$ -

Management's Discussion & Analysis

Unaudited (in millions of dollars except per common share and per Stapled Unit amounts)	2010					2009				
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
\$ per Stapled Unit ² – diluted										
Earnings (loss) from continuing operations available for distribution ¹	\$ (0.27)	\$ 0.19	\$ 0.05	\$ (0.54)	\$ (0.51)	\$ (0.05)	\$ (0.34)	\$ (0.29)	\$ 0.15	\$ (0.53)
Earnings (loss) from continuing operations available for distribution before accretion expense, change in fair value of financial instruments held for trading and provision for future income tax expense (recovery) ¹	\$ (0.06)	\$ 0.05	\$ (0.05)	\$ (0.03)	\$ (0.11)	\$ (0.17)	\$ (0.14)	\$ (0.11)	\$ (0.12)	\$ (0.54)
Distributable cash from continuing operations ¹	\$ (0.04)	\$ 0.06	\$ (0.05)	\$ (0.04)	\$ (0.08)	\$ (0.20)	\$ (0.07)	\$ (0.05)	\$ (0.13)	\$ (0.44)
Distributable cash from discontinued operations ¹	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0.01)
Distributable cash ¹	\$ (0.04)	\$ 0.06	\$ (0.05)	\$ (0.04)	\$ (0.08)	\$ (0.20)	\$ (0.07)	\$ (0.05)	\$ (0.13)	\$ (0.45)
Distributions paid ⁴	\$ -	\$ -	\$ -	\$ 0.04	\$ 0.04	\$ -	\$ -	\$ -	\$ -	\$ -
Sales by product (in millions of dollars)										
Logs	\$ 49.4	\$ 60.2	\$ 55.4	\$ 51.8	\$ 216.8	\$ 29.3	\$ 30.0	\$ 26.3	\$ 40.1	\$ 125.7
Real estate	1.0	10.0	0.5	2.7	14.2	0.2	6.7	7.9	0.3	15.1
Other ³	8.3	10.7	10.0	8.1	37.1	0.9	1.3	3.3	4.0	9.5
	58.7	80.9	65.9	62.6	268.1	30.4	38.0	37.5	44.4	150.3
Sales volume (million m ³)										
Logs										
Domestic	0.3	0.4	0.3	0.4	1.4	0.2	0.2	0.2	0.4	1.0
Japan and other Asian markets	0.4	0.4	0.4	0.3	1.5	0.1	0.2	0.2	0.2	0.7
United States	-	0.1	-	-	0.1	0.1	-	-	-	0.1
	0.7	0.9	0.7	0.7	3.0	0.4	0.4	0.4	0.6	1.8
Production volume (million m ³)										
Logs	0.6	0.7	0.5	0.7	2.5	0.3	0.3	0.3	0.6	1.5

1 Earnings from continuing operations available for distribution, distributable cash, basic and diluted earnings from continuing operations 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.

2 Per common share and per Stapled Unit amounts presented for each quarter have been determined based on the weighted average number of common shares or weighted average number of Stapled Units outstanding during the quarter. Per common share and per Stapled Unit amounts by quarter do not necessarily add to the total of the year due to changes in the weighted average number of common shares and Stapled Units outstanding during the year.

3 Other sales revenue is comprised of revenue from chartering vessels to ship to Asian markets, revenue under various fibre supply agreements as well as other miscellaneous revenue from the timberland operating segment.

4 Distributions paid in Q4 2010 were paid in kind by issuing 885,447 Stapled Units to unitholders on the record date.

The Company generally operates in a cyclical industry and 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.

Management's Discussion & Analysis

Q4 2010 vs. Q4 2009

Total sales increased by \$18.2 million to \$62.6 million in Q4 2010 over Q4 2009 due to an increase in log sales volumes and real estate sales. Operating earnings in Q4, 2010 were \$4.3 million compared to an operating loss of \$3.1 million for the fourth quarter of 2009.

Continuing operations generated a net loss of \$5.3 million before accretion and fair value adjustments of financial instruments net of income tax in Q4 2010 compared to Q4 2009 net earnings of \$39.2 million before fair value adjustments net of tax. This variance is primarily the result of a non-cash future income tax recovery of \$53.0 million recognized in Q4 2009.

Timberlands

(in millions of dollars except where otherwise noted)

	Q4 2010	Q4 2009
Log sales		
Domestic	\$ 19.1	\$ 22.2
Export – Asia	30.5	17.5
Export - USA	2.2	0.4
Total log sales	51.8	40.1
Freight and other sales	8.1	4.0
Total timberland sales	59.9	44.1
Log sales realizations (\$/m ³) - CAD		
Domestic	55	59
Export – Asia	92	86
Export - USA	54	63
Total log sales realizations - CAD	72	69
Log sales realizations (\$/m ³) – USD		
Domestic	53	54
Export – Asia	90	80
Export - USA	54	60
Total log sales realizations - USD	70	63
Log sales volume (thousand m ³)		
Domestic	347.5	374.5
Export – Asia	335.4	203.9
Export – USA	39.4	5.4
Total log sales volume	722.3	583.8
Log sales mix (thousand m ³)		
Fir	323.2	277.0
Hemba	336.4	225.9
Cedar	29.1	30.2
Other	33.6	50.7
Total log sales mix	722.3	583.8
Log production volume (thousand m ³)		
Public tenures	199.4	153.6
Private timberlands	486.6	456.0
Total production volume	686.0	609.6
Log production costs (\$/m ³)	64	62
Timberland cost of sales (\$/m ³)	63	64
Timberland operating margin (% of log sales)	11%	6%

Management's Discussion & Analysis

Timberland log sales were \$51.8 million in the fourth quarter of 2010, compared to \$40.1 million in Q4 2009. The increase was a result of improvements in both prices and volumes. Based on high demand in the export markets sales volumes in Q4 2010 were 722,312 m³ versus 583,834 m³ in Q4 2009. Sales realizations of \$72 per m³ in Q4 2010 was a \$3 per m³ improvement over Q4 2009. The realization improvement came despite a 5% strengthening of the Canadian dollar against its American counterpart.

Other sales in Q4 2010 include \$6.9 million (Q4 2009 - \$1.4 million) of revenue associated with TimberWest chartering its own vessels to ship to Asian markets. This revenue is a cost recovery of the amount incurred by TimberWest to charter these vessels.

Real Estate

(in millions of dollars except where otherwise noted)

	2010	2009
Sales	\$ 2.7	\$ 0.3
Price per acre (\$/acre)	10,344	8,824

Real estate sales improved from the prior year with sales of \$2.7 million in 2010 versus \$0.3 million in 2009.

Net earnings (loss)

Operating earnings in Q4 2010 was \$4.3 million. This was a \$7.4 million improvement over 2009's operating loss of \$3.1 million. Q4 net earnings from continuing operations include a change in fair value of financial instruments of \$46.4 million (2009 - \$29.7 million), and a non-cash future income tax recovery of \$1.9 million (2009 - \$53.0 million).

EBITDA

EBITDA from continuing operations for the quarter ended December 31, 2010, increased to \$5.7 million, compared to \$(1.0) million for Q4 2009. On a per weighted average Stapled Unit basis, EBITDA from continuing operations increased to \$0.06 for Q4 2010, from \$(0.01) in Q4 2009.

Distributable cash

Distributable cash from continuing operations for Q4 2010 was \$(3.2) million, an improvement of \$6.9 million from \$(10.1) million in Q4 2009.

Management's Discussion & Analysis

Distributions

TimberWest's policy is to make quarterly distributions to its unitholders in the form of interest on the Series A Subordinate Note component of the Company's Stapled Units held by unitholders. The Company has the right to defer distribution payments for up to 18 months. Given the challenging business conditions since 2008, the Company commenced the deferral of quarterly distribution payments in 2009 and will continue to defer distributions for the foreseeable future. Distributions previously deferred have been paid by the issuance of additional Stapled Units as the deferral period ends. On October 15, 2010, the Company paid the April 15, 2009 deferred distribution by issuing additional Stapled Units.

Deferred quarterly distributions will be payable by to the holders of Stapled Units of record on January 15, April 15, July 15 and October 15 in each year (Record Date) and are expected to be paid on the Record Date. The Company will determine on a quarterly basis as to whether deferred distributions will be paid in cash or by issuance of Stapled Units. The distribution rate for the foreseeable future has been set at 2%. 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, harvest levels and currency fluctuations. Distributions may vary from the actual cash generated during certain periods. When the interest rate is set at 2%, the Company has the ability to defer distributions for 18 months and the Company can pay distributions in kind by the issuance of additional Stapled Units. No distributions were paid in cash to unitholders for the years ended December 31, 2010 and December 31, 2009. On October 15, 2010 the Company paid the April 15, 2009 deferred distribution in kind, by issuing 885,447 Stapled Units to its unitholders of record on October 15, 2010. On January 17, 2011, the Company paid the July 15, 2009 distribution in kind, by issuing 785,854 Stapled Units to its unitholders of record on January 17, 2010.

Since the Company's inception in July 1997 to the end of 2010, the Company has generated distributable cash of \$791.9 million and the Company has distributed \$883.9 million in distributions to unitholders. As at December 31, 2010, the Company has deferred distributions with a face value of \$47.1 million.

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. 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.

Based on the Company's most recent determination, no depletion charge is required for 2010.

The Company's Long Term Economic Harvest Level (LTEHL) has been set at a total of 9.0 million m³ to be harvested over the next five years, or an average harvest volume of 1.8 million m³ per annum on the private lands. The LTEHL depicts the Company's planned harvest volume over the next five years with the best information available today on log prices, costs, logging constraints, and end user markets for the period. Market conditions may dictate harvesting more or less than the 1.8 million m³ in any one year but the average annual harvest over the five year period is projected to be 1.8 million m³. If the underlying assumptions in this LTEHL analysis remain unchanged in future years, the Company will be able to harvest 1.8 million m³ per year into perpetuity. Conditions may change when we revisit our LTEHL in future years and, if they do, the changes will be incorporated into our updated assumptions at that time. Variables which would positively influence the Company's LTEHL include emerging new markets for biomass materials (which are not in the production forecast today), shifts in log prices beyond the level currently contemplated, and the construction of new sawmills on the BC coast capable of processing smaller diameter wood on a profitable basis. Variables that would reduce the Company's LTEHL include further property sales or harvest restrictions associated with watersheds, riparian zones, wildlife corridors, or viewsapes beyond those already modeled.

Accounting for Series A Subordinate Notes

The Company has a unique equity instrument referred to as Stapled Units, each Stapled Unit consisting of one common share 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.

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 \$815.6 million as at December 31, 2010 (2009 - \$698.3 million). 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 and comprehensive income (loss). On December 19, 2008 the holders of the Stapled

Management's Discussion & Analysis

Units approved a series of Note Amendments that came into effect on December 31, 2008. The Note Amendments are as follows: (i) the rate of interest on the Series A Subordinate Notes payable was changed from a fixed 12% per annum to a variable rate between 2% and 12% per annum to be set from time to time based on the Company's distributable cash; (ii) the period over which the Company can defer payments of interest on the Notes was reduced from 27 months to 18 months, and the Company may only exercise this deferral right in respect of interest payments for periods where the applicable interest rate on the Subordinate Notes is 2%; and (iii) the Company's right to elect to pay interest on the Subordinate Notes by delivering common shares or preferred shares of the Company was replaced with the right to elect to pay interest on the Notes by delivering Stapled Units.

In accordance with GAAP, the Note Amendments had the effect of extinguishing the previous debt associated with the Series A Subordinate Notes and triggered a revaluation of debt on the extinguishment date (December 31, 2008). As a result of this revaluation, in 2008 the Company has recorded a gain on modification of Series A Subordinate Notes of \$461.6 million with a corresponding write-down to the Series A Subordinate Notes. The balance of the Series A Subordinate Notes will accrete up to its face value over the lifetime of the notes using the effective interest rate method. Accretion of \$7.4 million was recognized in 2010 (2009 - \$6.6 million).

The embedded derivative arising from the option to extend the Series A Subordinate Notes for a further 10 year period from 2038 to 2048 is measured at fair value. The fair value of this option is determined by an independent financial firm. The embedded derivative arising from the option to defer the quarterly interest payment of the Series A Subordinate Notes for a period up to 18 months is measured at fair value. As at December 31, 2010 the fair value of these options was \$6.7 million (2009- \$5.9 million).

Accounting for Convertible Debentures

The Company has elected to designate the convertible debentures as 'held-for-trading' and it is to be revalued at fair value at each reporting date. Changes in fair value from one period to the next are recognized in the statement of operations and comprehensive income (loss) in the period. At December 31, 2010 the fair value of the convertible debentures was \$248.1 million compared to \$207.8 million at the end of 2009. This overall increase of \$40.3 million represents an increase in fair value from the prior year of \$32.3 million (2009 - \$55.6 million) and the issuance of new convertible debentures with a face value of \$7.0 million, offset by convertible debenture conversion to Stapled Units of \$0.1 million. Convertible debentures at December 31, 2010 had a face value of \$160.3 million (2009 - \$153.4 million).

Transaction costs incurred on the issuance of the convertible debentures are expensed to the statement of operations and comprehensive income (loss). There were no transaction costs associated with the convertible debentures in 2010 (2009 - \$5.5 million).

Debentures with a face value of \$0.1 million were converted into 13,674 Stapled Units during the year ended December 31, 2010. Debentures with a face value of less than \$0.1 million were converted into 11,192 Stapled Units during the year ended December 31, 2009.

Accounting for Employee Future Benefits

TimberWest's pension and non-pension 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 non-pension 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

Management's Discussion & Analysis

calculation of these assets, liabilities and expenses, and the sensitivity of key assumptions are presented in note 15 of the annual consolidated financial statements.

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 6 of the annual consolidated financial statements.

Impact of Accounting Pronouncements Affecting Future Periods

International Financial Reporting Standards ("IFRS")

On February 13, 2008, the Canadian Accounting Standards Board ("AcSB") confirmed the use of International Financial Reporting Standards ("IFRS") to commence in 2011 for publicly accountable profit-oriented enterprises. IFRS will replace Canada's Generally Accepted Accounting Principles ("GAAP") and the official changeover date is for interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2011.

TimberWest will adopt IFRS according to requirements outlined by the AcSB, and is in the process of completing preparation for the adoption of IFRS effective January 1, 2011.

Impact of Adoption of International Financial Reporting Standards ("IFRS")

IFRS are premised on a conceptual framework similar to Canadian GAAP, however, significant differences exist in certain matters of recognition, measurement and disclosure.

IFRS Conversion project

The Company's IFRS conversion project began in 2008 and has established a formal project governance structure which includes the audit committee, senior management and a steering committee. A qualified external advisor has also been engaged by the Company to assist in the IFRS conversion project. The audit committee is updated on a quarterly basis and training is provided as necessary. The project is progressing according to plan and continues to be on track toward completion. The Company will issue its first interim consolidated financial statements in accordance with IFRS as issued by the International Accounting Standards Board ("IASB") beginning with the first quarter ending March 31, 2011, with comparative financial results for 2010.

Management's Discussion & Analysis

The Company's IFRS conversion project consisted of four phases: raise awareness; assessment; design; and implementation. The Company is currently in the final stages of the implementation phase. The Company expects the transition to IFRS to impact accounting, financial reporting, internal control over financial reporting, taxes and information systems and processes.

The adoption of IFRS by the Company is not expected to materially impact the distributable cash, EBITDA or debt covenant calculations as current credit agreements specify that covenants will continue to be calculated based on current GAAP.

Accounting Policy Impacts and Decisions:

The IASB has significant ongoing projects that could affect the ultimate differences between GAAP and IFRS and these changes may have a material effect on the Company's consolidated financial statements.

IFRS 1 First Time Adoption of International Financial Reporting Standards ("IFRS 1"):

IFRS 1 provides guidance on a number of optional exemptions that are available to the Company on transition to IFRS. These optional exemptions that are being considered by the Company and those expected to have a material effect of the opening balance sheet are as follows:

Fair value as deemed cost for property, plant and equipment:

IFRS 1 allows a first-time adopter of IFRS to elect to measure an item of property, plant and equipment at its deemed cost as at the date of transition. The Company currently expects to adopt this transitional exemption for certain items of property, plant and equipment at January 1, 2010. In addition to the reclassifications on transition noted below in "Private timberlands" and "Higher and better use lands", the impact to the Company of this optional exemption is expected to be a decrease in property, plant and equipment and a decrease in retained earnings in the range of \$60.0 to \$80.0 million.

Business combinations:

The Company expects to elect this exemption under IFRS, which removes the requirement to retrospectively restate all business combinations in accordance with IFRS 3, *Business Combinations*, prior to the date of transition to IFRS.

Employee future benefits:

IFRS 1 provides an option to recognize all cumulative actuarial gains and losses on defined benefit pension plans existing at the date of transition immediately in retained earnings, rather than continuing to defer and amortize into the profit or loss. The Company currently expects to adopt this transitional exemption, with a decrease to retained earnings and an increase to liabilities of approximately \$8.0 million.

Significant Accounting Policy Changes:

The Company has identified the following areas as having significant accounting policy changes and impact on the Company's consolidated financial statements and disclosures when IFRS is adopted:

Private timberlands:

The Company's private timberlands will be accounted for as a biological asset under IAS 41, *Biological Assets*. The Company's private timberlands will be separated into standing timber and land. The private standing timber will be valued at fair value at each reporting date. Any changes in fair value, as a result of growth, harvest, and changes in valuation assumptions will be recognized as a gain or loss on the face of the profit or loss. The land component of the private timberlands will be accounted for as property, plant and equipment. Upon harvesting, timber from private timberlands will be considered agricultural produce and will be accounted for at fair market value less the estimated costs to sell. This value will be the cost ascribed to the logs as they enter inventory.

Management's Discussion & Analysis

During the year the Company, in conjunction with a third party valuation expert, assessed the fair value of its private timberlands which included standing timber, land and land improvements, as of January 1, 2010. The fair value associated with the Company's private timberlands at January 1, 2010 is currently estimated to be in the range of \$820.0 million to \$840.0 million, of which \$720.0 million to \$740.0 million related to the standing timber. The expected impact of recognizing this fair value of standing timber is a decrease in property, plant and equipment and retained earnings on transition date in the range of \$180.0 million to \$200.0 million. However, on transition, the standing timber value will be reclassified as biological assets on the face of the Company's consolidated balance sheet, rather than being included within property, plant and equipment.

Management is in the process of assessing the fair value of its private timberlands as at December 31, 2010. Any changes in value to the biological assets will be reflected in the profit or loss during 2010.

Higher and better use lands:

The Company's higher and better use lands will be accounted for as investment property under IAS 40, *Investment Property*. The Company had previously identified 134,000 acres of land that, over an extended period of time, will have a higher and better use other than as timberlands. During 2010, the Company continued to assess this portfolio of land and determined that 56,000 acres of higher and better use lands are held for capital appreciation and as such will be accounted for as investment property under IFRS.

The Company currently expects to elect to measure its investment property using the fair value model, in which each property is measured at fair value at each reporting date, with changes in fair value recognized in profit or loss as incurred.

During the year the Company, in conjunction with a third party valuation expert assessed the fair value of its investment property, as of January 1, 2010, to be in the range of \$140.0 million to \$160.0 million. The expected impact of recognizing this fair value of investment property is an increase in property, plant and equipment and retained earnings on transition date in the range of \$50.0 million to \$70.0 million. However, on transition, the fair value of these higher and better use lands will be reclassified as investment property on the face of the Company's consolidated balance sheet, rather than being included within property, plant and equipment.

Management is in the process of assessing the fair value of its higher and better use lands as at December 31, 2010. Any changes in value to investment property will be reflected in the profit or loss during 2010.

Provisions, including asset retirement obligations:

IFRS has a lower recognition threshold for provisions and minor measurement differences when compared to GAAP. These measurement differences include the requirement to reflect the risks associated with asset retirement obligations, such as reforestation obligations, in either the cash flows or discount rate. It is likely that the risks associated with the Company's reforestation obligations would be reflected in its estimated cash flows, and as a result, the asset retirement obligations would be discounted using the risk-free rate. As a result, the Company currently expects an increase in liabilities and decrease in retained earnings of less than \$1.0 million.

Income taxes:

As a result of the aforementioned expected adjustments, future income taxes at January 1, 2010 are currently under review and are not quantifiable at this time.

IFRS Impact:

The Company currently expects the potential overall decrease to opening retained earnings on January 1, 2010 to be in the range of \$160 million to \$210 million.

The discussion above on IFRS outlines to the reader the Company's IFRS conversion project and the potential effect on the consolidated financial statements. This information does not represent the official adoption of IFRS by the Company and is intended only to provide an indication of the major differences identified to date based on current IFRS guidance, relative to the Company's GAAP accounting policies at transition date. The proposed IFRS 1

Management's Discussion & Analysis

optional exemptions, the selection of IFRS accounting policies and any related adjustments to the consolidated financial statements are in the process of being finalized and audited. As a result, the discussion noted above is subject to change.

Risk Management and Uncertainties

The Company's operations are subject to a number of risks and uncertainties. For a discussion of risks and uncertainties please refer to the Company's Annual Information Form for the year ended December 31, 2010 dated February 10, 2011. The document is available at www.sedar.com

Disclosure Controls and Internal Control over Financial Reporting

Based on current securities legislation in Canada, the Chief Executive Officer and the Chief Financial Officer of the Company are required to certify that they have:

- designed the Company's disclosure controls and procedures, or caused them to be designed under their supervision;
- designed the Company's internal control over financial reporting, or caused it to be designed under their supervision; and
- evaluated the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of December 31, 2010.

During 2010, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

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 and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of December 31, 2010. In addition, independent testing of the effectiveness of the Company's disclosure controls and procedures and the Company's internal control over financial reporting as of December 31, 2010 was performed. Based on that evaluation, the Company's management concluded that the Company's disclosure controls and procedures and the Company's internal control over financial reporting were effective as of December 31, 2010.

Management's Discussion & Analysis

Outlook

Business conditions improved significantly in 2010 and further improvement is expected in 2011 and beyond. The rapid emergence of Asia over the past two years has created a new paradigm for TimberWest, favourably impacting both log volumes and prices. Importantly, Asian demand is driving log prices not only in Asia but in North America and this has been the case since Q2, 2009 when prices generally started their gradual, steady climb to where they are today. In spite of cyclical lows in the level of US housing starts, by the beginning of Q1, 2011, prices for hemlock logs off of private land in the US Pacific Northwest ("US PNW") were higher than at the peak reached in 2006 when US housing starts were at a cyclical high. Similarly, Douglas fir pricing is now at its highest level since 2006 and within 15% of its peak that year in the US PNW. With both species, growth in Chinese demand is the driver.

As we look forward, softwood demand in China is projected to continue increasing as a result of general economic growth and there is expected to be a continuing fibre supply gap. Japan is expected to remain strong and stable. In the US, the housing market is expected to gradually recover after its lengthy downturn. During the same period of time that the US housing industry rebuilds, supply restrictions caused by the Mountain Pine Beetle epidemic that are already being felt will become progressively worse.

Over the next few years, we anticipate steadily improving US housing starts until we get back to a sustainable level of some 1.6 to 1.7 million new housing starts per year, continued demand growth in Asia, tightening log supply in North America and restricted log flow out of Russia. All of this is expected to result in meaningfully higher log prices and improved margins for TimberWest. If the US dollar regains some of its strength, the impact on TimberWest sales realizations will be even more positive.

In addition to real estate properties, we will see further development in the measurement and subsequent sale of carbon credits as well as advances in our wind and biomass energy projects. With the exception of carbon credits, these projects have a long term gestation period and, as such, will not have any meaningful impact on 2011 results. With respect to carbon credits, 2011 should see our first sale. Though the initial program will be small, we envision growing carbon sales to a meaningful level in future years.

Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

Management's Responsibility

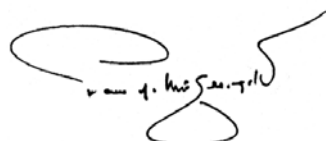
To the Unitholders of TimberWest Forest Corp.:

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.

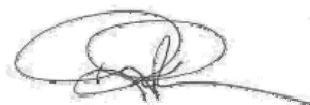
To assist management in fulfilling its responsibilities, a system of internal accounting controls has been established to provide reasonable assurance that the consolidated financial statements are accurate and reliable and that assets are safeguarded. Management believes that this system of internal controls has operated effectively for the year ended December 31, 2010.

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. McELGOTT
President and Chief Executive Officer
TimberWest Forest Corp.



ROBERT ALLEN
Vice President Finance and
Chief Financial Officer
TimberWest Forest Corp.

February 10, 2011

Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

Independent Auditors' Report

To the Unitholders of TimberWest Forest Corp.:

We have audited the accompanying consolidated financial statements of TimberWest Forest Corp. ("the Company"), which comprise the balance sheets as at December 31, 2010 and 2009 and the statements of operations and comprehensive income (loss), retained earnings, and cash flows for the years then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of TimberWest Forest Corp. as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, slightly slanted style. Below the signature, there is a horizontal line that starts under the "K" and extends to the right, ending under the "P".

Chartered Accountants
Vancouver, Canada
February 10, 2011

Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

Consolidated Statements of Operations and Comprehensive Income (Loss)

(in millions of dollars, except per common share amounts)	2010	2009
Sales	\$ 268.1	\$ 150.3
Operating costs and expenses:		
Cost of sales	235.5	147.0
Selling, administrative and other	11.6	11.9
Depreciation, depletion and amortization	4.3	4.4
	251.4	163.3
Operating earnings (loss) from continuing operations	16.7	(13.0)
Interest expense:		
Series A Subordinate Notes owned by unitholders	24.0	20.8
Convertible debentures	14.5	11.9
Long-term bank debt	9.1	9.7
Short-term bank debt	-	0.5
	47.6	42.9
Financing transaction costs	-	5.5
Amortization of deferred financing costs (note 12)	2.8	1.9
Change in fair value of financial instruments held for trading (notes 10, 13 and 19(a))	31.5	54.4
Other expense (income)	-	(0.2)
	81.9	104.5
Loss before income taxes from continuing operations	(65.2)	(117.5)
Income tax recovery (note 6)	(5.0)	(62.1)
Net earnings (loss) and comprehensive earnings (loss) from continuing operations	(60.2)	(55.4)
Net earnings (loss) and comprehensive earnings (loss) from discontinued operations (note 5)	-	(0.4)
Net earnings (loss) and comprehensive earnings (loss)	\$ (60.2)	\$ (55.8)
Basic and diluted earnings (loss) from continuing operations per common share (note 7)	\$ (0.70)	\$ (0.71)
Basic and diluted earnings (loss) from discontinued operations per common share (note 7)	-	(0.01)
Basic and diluted earnings (loss) per common share (note 7)	(0.70)	(0.72)

Consolidated Statements of Retained Earnings

(in millions of dollars)	2010	2009
Retained earnings, beginning of year	\$ 195.0	\$ 250.8
Net earnings (loss) and comprehensive earnings (loss) for the year	(60.2)	(55.8)
Retained earnings, end of year	134.8	195.0

See accompanying notes to consolidated financial statements.

Consolidated Financial Statements

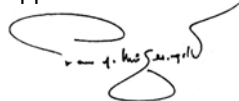
Years Ended December 31, 2010 & 2009

Consolidated Balance Sheets

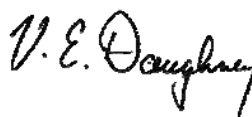
(in millions of dollars)	2010	2009
Assets		
Current assets:		
Cash	\$ 3.5	\$ 1.8
Accounts receivable	6.2	5.8
Inventories (note 8)	36.7	27.2
Prepaid expenses and other current assets	7.3	3.0
Future income taxes (note 6)	1.9	1.6
	55.6	39.4
Property, plant and equipment (note 9)	1,209.7	1,213.0
Other assets (note 10)	10.6	12.0
	\$ 1,275.9	\$ 1,264.4
Liabilities and Unitholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 23.9	\$ 23.9
Deferred distribution payable (note 11)	34.1	3.3
Discontinued operations	-	0.2
	58.0	27.4
Revolving credit facility (note 12)	106.5	152.6
Convertible debentures (note 13)	248.1	207.8
Long-term silviculture liability (note 14)	3.5	3.0
Employee future benefits (note 15)	36.9	37.1
Deferred distribution payable (note 11)	11.1	28.8
Stapled Unit option plan (note 17)	1.4	1.5
Future income taxes (note 6)	166.9	171.1
	632.4	629.3
Series A Subordinate Notes owned by unitholders (note 16)	315.1	247.1
	947.5	876.4
Unitholders' equity		
Share capital (note 16)	191.5	191.0
Contributed surplus	2.1	2.0
Retained earnings	134.8	195.0
	328.4	388.0
	\$ 1,275.9	\$ 1,264.4

Commitments and contingencies (note 18)
 Subsequent event (notes 11, 13 and 20)
 See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Directors:



Paul J. McElligott
 Director



V. Edward Daughney
 Director

Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

Consolidated Statements of Cash Flows

(in millions of dollars)	2010	2009
Cash provided by (used in):		
Operating activities:		
Net loss from continuing operations	\$ (60.2)	\$ (55.4)
Items not involving cash:		
Depreciation, depletion and amortization	7.1	6.3
Accretion on Series A Subordinate Notes	7.4	6.6
Gain on sale of property, plant and equipment	(6.7)	(5.7)
Future income tax expense (recovery)	(4.5)	(62.1)
Change in deferred distribution payable	16.6	14.3
Change in fair value of financial instruments held for trading	31.5	54.4
Convertible debenture interest paid in kind	7.0	3.4
Other non-cash items	0.5	1.7
	(1.3)	(36.5)
Changes in non-cash working capital:		
Accounts receivable	(0.4)	(1.7)
Inventories	(9.5)	1.9
Prepaid expenses and other working capital	(4.3)	0.7
Accounts payable and accrued liabilities	0.9	(1.1)
	(13.3)	(0.2)
	(14.6)	(36.7)
Financing activities:		
Issuance of Stapled Units		
Series A Subordinate Notes	60.0	-
Share capital	0.5	-
Revolving credit facilities	(46.1)	(37.2)
Convertible debentures	-	150.0
Term credit facilities	-	(108.3)
Financing transaction costs	(3.2)	(5.9)
	11.2	(1.4)
Investing activities:		
Proceeds from sale of property, plant and equipment	12.6	12.8
Additions to property, plant and equipment	(6.9)	(1.3)
Other assets	(0.6)	(0.8)
	5.1	10.7
Cash provided by (used in) continuing operations	1.7	(27.4)
Cash provided by (used in) discontinued operations (note 5)	-	(1.6)
Increase (decrease) in cash and cash equivalents	1.7	(29.0)
Cash and cash equivalents, beginning of year	1.8	30.8
Cash and cash equivalents, end of year	\$ 3.5	\$ 1.8
Supplemental information:		
Interest on the convertible debentures paid in cash	7.2	5.2
Other interest paid	9.0	11.4
Financing costs paid	3.2	11.4

See accompanying notes to consolidated financial statements.

Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

Consolidated Business Segments

2010

(in millions of dollars)	Timberlands	Real Estate	Other	Total
Sales	\$ 253.9	\$ 14.2	\$ -	\$ 268.1
Operating earnings (loss)	26.1	4.4	(13.8)	16.7
Total assets	1,125.7	126.3	23.9	1,275.9
Additions to property, plant and equipment	1.9	3.4	1.6	6.9

2009

(in millions of dollars)	Timberlands	Real Estate	Other	Total
Sales	\$ 135.2	\$ 15.1	\$ -	\$ 150.3
Operating earnings (loss)	(2.7)	4.4	(14.7)	(13.0)
Total assets	1,117.8	127.7	18.9	1,264.4
Additions to property, plant and equipment	0.4	0.8	0.1	1.3

In 2009, the Company commenced reporting its operating results on a segmented basis in order to disclose the results of its two significant operating segments, timberlands and real estate. Prior to 2009, the Company operated in one operating segment, timberlands, and any real estate sales were incidental to the timberland operations. Effective January 1, 2009, the Company has formed a real estate division and the activities of this division are managed separately from the timberlands operation. Sales and operating earnings reflect the income and expenses of each segment.

TimberWest has identified 56,000 acres of land that, over an extended period of time, will have a higher and better use than timberland. This represents about 7% of the Company's landholdings. This is the portion of the land base that has the highest potential value to be realized from planning and zoning changes. This land is suitable for residential, commercial, industrial, and resort development.

TimberWest had previously disclosed that 134,000 acres of land that, over an extended period of time, will have a higher and better use than timberland. The initial analysis was that over a very long period of time, a larger portion of the land base will have a higher and better use than timberland. Although the Company still believes this to be the case, the holding period is beyond a normal planning cycle. With the benefit of additional studies and review, the Company has determined 56,000 acres to be the relevant higher and better use land base for the foreseeable future. The result of this further analysis is that the Company will be able to better focus on a smaller portfolio of higher and better use land and pursue planning and zoning changes to achieve the highest potential value.

The focus of the real estate group is to work closely with Vancouver Island communities to determine the best use of these lands.

From time to time the Company will sell land "as is". For these properties, analysis indicates that TimberWest would not benefit from spending additional resources on this land to plan and entitle it, but should rather go through an orderly disposition of the properties. The value of these properties for real estate purposes exceeds their value in a forestry operation.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(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) and include the following policies:

(a) Going concern:

At December 31, 2010, the Company had total liquidity available of \$102.5 million, an increase of \$49.7 million from the prior year. Based on the Company's current liquidity position and forecasted cash requirements over fiscal 2011, the Company does not foresee any going concern issues in 2011.

The Company's \$230 million revolving credit facility becomes due on February 11, 2012. The Company has been in discussions with its current lenders and other parties on replacement financing for this facility and the Company expects to complete the refinancing in fiscal 2011 prior to maturity.

The Company's ability to continue as a going concern beyond fiscal 2011 will be dependent on the economic factors affecting the Company's core businesses – timberland operations and real estate. Although the Company is confident in its ability to renew or replace the revolving credit facility and of the future profitability of its operations and assets, the Company recognizes that the Company's results will be affected by economic, competitive and other factors, many of which are beyond the Company's control.

(b) Basis of presentation and 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.

As described in note 5, the Company permanently closed its Elk Falls sawmill operations on May 9, 2008. These operations have been classified as discontinued operations and prior period financial statements have been restated as required by CICA Section 3475, *Disposal of Long-lived Assets and Discontinued Operations*.

(c) 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 and records its estimates, including those related to litigation, environmental liabilities, inventory valuation, asset 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.

(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 delivery terms of the sales contract. Revenue is only recorded when collection is reasonably assured.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

1. Summary of significant accounting policies (continued)

(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 fair value.

(g) Accounts receivable:

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

(h) Inventories:

Inventories other than supplies are recorded at the lower of average cost and net realizable value on an item-by-item basis defined as end-use-sorts for logs.

(i) Deferred debt issue costs:

Debt issue costs related to revolving credit facilities are accounted for as contract-based intangible assets, and are deferred and amortized on a straight line basis over the respective terms to maturity. The Company's debt issue costs are incurred for its revolving credit facilities and lines of credit and are therefore outside the scope of transaction costs for financial instruments.

(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
Building	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. Capital logging roads and permanent bridges are amortized on a straight-line basis over 12 years, which approximates the utilization of the related timber resources. Portable bridges are amortized on a straight-line basis over 20 years, which approximates their lifespan.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(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 (continued):

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. 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.

The Long Term Economic Harvest Level (LTEHL) depicts the Company's planned harvest volume over the next five years with the best information available today on log prices, costs, logging constraints, and end user markets for the period. Based on the Company's most recent determination, no depletion charge is required for 2010.

The LTEHL was set at 9.0 million m³ for the next five years, or an average sustainable harvest volume of 1.8 million m³ per annum on the private lands. At December 31, 2010, the LTEHL remains at 9.0 million m³ for the next five years, or an average sustainable harvest volume of 1.8 million m³ per annum on the private lands. 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 in accounts payable and accrued liabilities and the remainder is classified as a long-term liability.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(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 15. 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.

(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) Stapled Unit option plan:

The Company has established Stapled Unit option plans for eligible directors, officers and employees as described in note 17. The option to acquire a Stapled Unit effectively provides the option holder with an option on the Series A Subordinated Note component and an option on the equity component of the Stapled Unit.

An option to acquire a debt instrument is accounted for under the intrinsic value method whereby the compensation cost is determined each period based on the fair value of the debt instrument compared to the exercise price of the option to acquire the debt instrument. The fair value of the equity component is based on the fair value of the option as determined using an option pricing model.

With the changes to the Series A Subordinate Note terms including modifying the interest rate to a variable rate from 2% to 12% which is ultimately based on distributable cash levels and the current market value of the Stapled Unit which is below the face value of the Series A Subordinate Note, the Company determined that the value of the Stapled Unit option is in the debt component and that the equity option value is immaterial. As a result, the accounting for the options issued in the period has been done using the intrinsic value method.

Historically, the Company has determined that the intrinsic value of the option to acquire the Series A Subordinate Notes has not been material and the fair value of the option has been recorded in equity as contributed surplus based on the fair value as determined by the Black Scholes option pricing model.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

1. Summary of significant accounting policies (continued)

(o) Stapled Unit option plan (continued):

Under the Company's Distribution Equivalent 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.

(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.

(q) Financial instruments:

The Company has classified its cash and cash equivalents as held-for-trading and recorded them at fair value. Accounts receivable, and receivables on the sale of property, plant and equipment, are classified as loans and receivables and are measured at amortized cost. The Company's drawings on available credit facilities, accounts payable and accrued liabilities are classified as other liabilities, all of which are measured at amortized cost. Deferred distributions payable are classified as held-for-trading and are recorded at fair market value. The Company's convertible debentures and interest payable are designated as held-for-trading and are recorded at fair market value.

Transaction costs incurred relating to the Company's revolving credit facilities and lines of credit are deferred and capitalized on the balance sheet as they relate to debt refinancing held at amortized cost.

The Company considers its Series A Subordinate Notes owned by unitholders as a variable rate liability and measures these instruments at amortized cost using the effective interest method. The effective interest method establishes the rate which equates the estimated future cash flows with the net carrying amount of the financial liability. The embedded derivative arising from the option to extend the Series A Subordinate Notes for a further 10 year period is measured at fair value. The embedded derivative arising from the option to defer the 2% distributions on the Series A Subordinate Notes for up to 18 months is measured at fair value.

(r) Accounting changes:

Accounting changes, which require that: (i) a voluntary change in accounting principles can be made if, and only if, the changes result in more reliable and relevant information, (ii) changes in accounting policies are accompanied with disclosures of prior period amounts and justification for the change, and (iii) for changes in estimates, the nature and amount of the change should be disclosed.

(s) Comparative figures:

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

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

2. Future accounting changes

International Financial Reporting Standards (“IFRS”):

On February 13, 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed the use of International Financial Reporting Standards (“IFRS”) to commence in 2011 for publicly accountable profit-oriented enterprises. IFRS will replace Canada’s Generally Accepted Accounting Principles (“GAAP”) and the official changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

TimberWest will adopt IFRS according to requirements outlined by the AcSB and with adoption of IFRS on January 1, 2011.

The Company has identified the following areas as having significant accounting policy changes and impact on the Company’s consolidated financial statements and disclosures when IFRS is adopted:

Private timberlands:

The Company’s private timberlands will be accounted for as a biological asset under IAS 41, *Biological Assets*. The Company’s private timberlands will be separated into standing timber and land. The private standing timber will be valued at fair value at each reporting date. Any changes in fair value, as a result of growth, harvest, and changes in valuation assumptions will be recognized as a gain or loss on the face of the profit or loss. The land component of the private timberlands will be accounted for as property, plant and equipment. Upon harvesting, timber from private timberlands will be considered agricultural produce and will be accounted for at fair market value less the estimated costs to sell. This value will be the cost ascribed to the logs as they enter inventory.

Higher and better use lands:

The Company’s higher and better use lands of 56,000 acres will be accounted for as investment property under IAS 40, *Investment Property*.

The Company currently expects to elect to measure its investment property using the fair value model, in which each property is measured at fair value at each reporting date, with changes in fair value recognized in profit or loss as incurred.

Provisions, including asset retirement obligations:

IFRS has a lower recognition threshold for provisions and minor measurement differences when compared to GAAP. These measurement differences include the requirement to reflect the risks associated with asset retirement obligations, such as reforestation obligations, in either the cash flows or discount rate. It is likely that the risks associated with the Company’s reforestation obligations would be reflected in its estimated cash flows, and as a result, the asset retirement obligations would be discounted using the risk-free rate.

Income taxes:

As a result of the aforementioned expected adjustments, future income taxes at January 1, 2010 are currently under review.

Refer to the Company’s MD&A ‘*Impact of Accounting Pronouncements Affecting Future Periods*’ for additional detail on the IFRS conversion project.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

3. Capital management

TimberWest's objectives for managing capital are to safeguard its ability to continue as a going concern, to provide a sufficient return to its unitholders, and to meet external capital requirements on its debt and credit facilities.

The Company manages its capital by monitoring its consolidated debt-to-total capitalization ratio. Debt is the total amount of borrowings on its revolving credit facility on the balance sheet and excludes the Company's convertible debentures. Total capitalization is calculated as the sum of Series A Subordinate Notes, plus unitholders' equity which includes share capital, contributed surplus, retained earnings and convertible debentures. As the Company's Series A Subordinate Notes trade only as part of the Company's equity instrument, the Stapled Unit, they are not included in the Company's definition of debt.

In 2010, the Company managed its capital by issuing 12 million Stapled Units in a public offering for gross proceeds of \$60 million. These proceeds were used to pay down the revolving credit facility. The Company maintained the distribution rate on the Series A Subordinate Notes at 2% and continued deferring these payments for 18 months. As previously deferred distributions came due, the Company paid these obligations in kind with the issuance of Stapled Units. As part of the Stapled Unit public offering completed in the year, the Company amended the terms of its revolving credit facility with its lenders, which allowed for the interest payments on the convertible debentures to be paid in cash, starting with the July 15, 2010 payment.

In 2009, the Company managed its capital by changing the variable interest rate on the Series A Subordinate Notes from 12% to 2% based on the Company's distributable cash and by deferring payments of interest on the Notes for up to 18 months. The Company issued convertible debentures, commenced paying interest on the convertible debentures in kind, and entered into revolving credit facilities amended during the year.

TimberWest's consolidated debt-total capitalization ratio as at December 31, 2010 was 11:89 as compared to 15:85 as at December 31, 2009.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

4. Segmented information

Commencing in 2009, the Company identified two reporting segments:

Timberlands – The Timberland division maximizes value by harvesting logs in a cost-effective manner consistent with sound safety, environmental and sustainable forestry practices and selling these products to targeted customers in both the domestic and higher value international markets.

Real Estate – Couverdon, the real estate division of TimberWest, has developed a long range strategic plan to realize value from land that has a higher and better use than timberlands.

The segments are managed separately. During the first quarter of 2009, the Company branded its real estate division “Couverdon Real Estate.”

Sales by geographic area are as follows:

	2010	2009
Timberland sales		
Canada	\$ 80.9	\$ 59.8
Japan	80.7	47.8
China	47.8	10.0
Korea	34.9	11.3
United States	8.9	4.9
Taiwan	0.7	1.4
	253.9	135.2
Real estate sales		
Canada	14.2	15.1
	\$ 268.1	\$ 150.3

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

In 2010 and 2009, the Company had sales to one customer whose individual purchases accounted for over 10% of the Company’s consolidated sales.

5. Discontinued operations

On May 9, 2008, the Elk Falls sawmill and planer mill in Campbell River, B.C. was permanently closed including the associated shipping operations at Stuart Channel Wharves located in Crofton, B.C. Subsequent to the closure, TimberWest disposed of all the sawmill assets and dismantled the sawmill. Ongoing costs such as property taxes and insurance continue to be expensed as incurred. The Company is assessing alternatives for the former sawmill site.

	2010	2009
Sales	\$ -	\$ -
Loss before income taxes	-	(0.4)
Net loss	-	(0.4)

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

5. Discontinued Operations (continued)

	2010	2009
Cash flow from operating activities	\$ -	\$ (1.6)
Cash flow from financing activities	-	-
Cash flow from investing activities	-	-
Cash flow provided by operations	\$ -	\$ (1.6)

Cash used in operating activities includes the payment of previously accrued liabilities due to the closure of the sawmill.

6. Income taxes

	2010	2009
Current income tax recovery	\$ (0.5)	\$ -
Future income tax recovery	(4.5)	(62.1)
	\$ (5.0)	\$ (62.1)

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

	2010	2009
Loss before income taxes from continuing operations	(65.2)	(117.5)
Loss before income taxes from discontinued operations	-	(0.4)
Loss before income taxes	(65.2)	(117.9)
Income tax recovery at statutory rates (2010 -28.5%; 2009 – 30.0%)	(18.6)	(35.4)
Current income tax recovery	(0.5)	-
Adjustment to net future tax liabilities for changes in tax rates	0.3	(3.5)
Change in valuation allowance relating to prior year losses	-	(63.3)
Permanent differences tax affected at statutory tax rates	7.3	13.5
Change in prior year estimated tax values	6.6	22.7
Effect of expired tax losses	-	3.9
Other	(0.1)	-
Income tax recovery	(5.0)	(62.1)
Income tax recovery from continuing operations	\$ (5.0)	\$ (62.1)

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

6. Income taxes (continued)

The tax effect of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at December 31, 2010 and 2009, are presented below:

	2010	2009
Net future tax assets:		
Current silviculture liability	\$ 0.6	\$ 0.5
Accruals for financial reporting purposes not deductible for tax purposes	1.3	1.1
Net future tax assets, current	\$ 1.9	\$ 1.6
Net future tax liabilities:		
Private timberlands	\$ (135.2)	\$ (155.2)
Other property, plant & equipment	11.5	8.8
Other assets	(0.2)	3.3
Non-pension benefits	9.2	9.3
Long-term silviculture liability	0.9	0.7
Series A Subordinate Notes	(111.3)	(113.2)
Deferred distribution payable	(0.5)	(0.8)
Non-capital loss carryforwards	58.7	76.0
Net future tax liabilities, non-current	\$ (166.9)	\$ (171.1)

7. Earnings (loss) per common share

	2010	2009
Net earnings (loss) and comprehensive income (loss) from continuing operations	\$ (60.2)	(55.4)
Net earnings (loss) and comprehensive income (loss)	\$ (60.2)	(55.8)
Basic weighted average number of common shares	85,553,884	77,772,122
Incremental common shares from potential exercise of options	470,452	227,139
Diluted weighted average number of common shares	86,024,336	77,999,261
Basic and diluted net earnings (loss) from continuing operations per common share	\$ (0.70)	(0.71)
Basic and diluted net earnings (loss) per common share	\$ (0.70)	(0.72)

8. Inventories

	2010	2009
Logs	\$ 36.7	\$ 27.2

The write-down associated with accounting for log inventories at net realizable value has decreased by \$1.1 million at December 31, 2010, which was offset against cost of sales for the period (2009 – the log inventory write-down decreased by \$0.6 million and was offset against cost of sales).

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

9. Property, plant & equipment

The Company reviews long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. The Company tests for impairment using a two-step methodology:

- (i) Determine whether the projected undiscounted future cash flows from operations exceed the net carrying amount of the assets as of the assessment date, and
- (ii) If assets are determined to be impaired in step (i), then such impaired assets are written down to their fair value, determined principally by using discounted future cash flows expected from their use and eventual disposition.

At year end, the Company conducted step (i) impairment tests on its long lived assets. Estimates of future cash flows used to test the recoverability of long-lived assets included key assumptions related to forecast prices, growth and yield expectations, production levels, production costs, market supply and demand, currency fluctuations and capital spending. The assumptions are derived from information generated internally and other external published reports and forecasts prepared by various industry experts. Product sales prices were based on management's best estimates incorporating independent market information as well as analysis of historical data, trends and cycles. The Company is estimating an improvement in pricing in the future from the current depressed prices.

Based on these assumptions, the Company's projected undiscounted cash flows from operations exceed the net book value of the Company's long lived assets by a considerable margin. As a result, the Company is not required to perform the second step of comparing the net book value of the long lived assets to fair value.

Estimates of future cash flows and fair value require judgments, assumptions and estimates and may change over time. Due to the variables associated with judgments and assumptions used in these tests, the precision and accuracy of estimates of impairment charges are subject to significant uncertainties and may change significantly as additional information becomes known. Long-lived assets represented approximately 95% of total assets as at December 31, 2010 (2009 – 96%). If future developments were to differ adversely from management's best estimate of key assumptions and associated cash flows, the Company could potentially experience future material impairment charges.

2010	Cost	Accumulated depreciation	Net book value
Logging buildings and equipment	\$ 14.1	\$ 8.4	\$ 5.7
Other equipment and facilities	8.8	6.4	2.4
Land	10.7	-	10.7
	\$ 33.6	\$ 14.8	18.8
Timberlands (including \$1,163.4 million of private lands) and logging roads (net of depletion and amortization)			
Timberland operating segment			1,065.3
Real estate operating segment			125.6
			1,190.9
			\$ 1,209.7

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

9. Property, plant & equipment (continued)

2009	Cost	Accumulated depreciation	Net book value
Logging buildings and equipment	\$ 13.5	\$ 7.7	\$ 5.8
Other equipment and facilities	7.5	6.0	1.5
Land	10.7	-	10.7
	\$ 31.7	\$ 13.7	18.0
Timberlands (including \$1,165.9 million of private lands) and logging roads (net of depletion and amortization)			
Timberland operating segment			1,067.8
Real estate operating segment			127.2
			1,195.0
			\$ 1,213.0

During the year, the Company sold 2,959 acres (2009 – 3,493 acres) of land with a net book value of \$5.9 million (2009 - \$7.1 million) for a gain of \$6.7 million (2009 - \$5.7 million).

10. Other assets

	2010	2009
Deferred financing costs	\$ 2.6	\$ 5.4
Financial instruments	6.7	5.9
Other	1.3	0.7
	\$ 10.6	\$ 12.0

The Company has the option to defer the distributions payable to its unitholders for a period of up to 18 months in length while the distribution rate is set at 2% (note 16). This option constitutes an embedded derivative and is measured at its fair value. As the Company has elected to defer distributions for the immediate future, the value to the Company of this option at December 31, 2010 is \$6.0 million (2009 - \$5.2 million).

The embedded derivative arising from the option to extend the maturity of the Series A Subordinate Notes for a further 10-year period from 2038 to 2048 is measured at its fair value of \$0.7 million (2009 - \$0.7 million).

Changes in the fair value of these embedded derivatives from one period to the next are recognized in the statement of operations and comprehensive income (loss) in the period (note 19(a)).

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

11. Deferred distribution payable

	Rate	Due Date	Face Value	2010	2009
January 15, 2011 distribution	2%	July 15, 2012	\$ 4.1	\$ 3.7	\$ -
October 15, 2010 distribution	2%	April 15, 2012	4.0	3.7	-
July 15, 2010 distribution	2%	January 15, 2012	4.0	3.7	-
April 15, 2010 distribution	2%	October 15, 2011	3.5	3.3	-
January 15, 2010 distribution	2%	July 15, 2011	3.5	3.4	3.1
October 15, 2009 distribution	2%	April 15, 2011	3.5	3.4	3.2
July 15, 2009 distribution	2%	January 15, 2011	3.5	3.5	3.3
April 15, 2009 distribution	2%	October 15, 2010	-	-	3.3
January 15, 2009 distribution	12%	April 15, 2011	21.0	20.5	19.2
			\$ 47.1	\$ 45.2	\$ 32.1
Less current portion			(35.0)	(34.1)	(3.3)
			\$ 12.1	\$ 11.1	\$ 28.8

The Company can defer distributions on its Series A Subordinate Notes after December 31, 2008 for up to 18 months (note 16) and can defer the January 15, 2009 distribution only for up to 27 months. As a result of these deferrals, the deferred distribution payable is accounted for at its fair value and the obligation is revalued at each reporting date.

On October 15, 2010, the April 15, 2009 deferred distribution of \$3.5 million was paid in kind by the issuance of 885,447 Stapled Units (note 16). Subsequent to December 31, 2010, on January 17, 2011, the July 15, 2009 deferred distribution of \$3.5 million was paid in kind by the issuance of 785,854 Stapled Units.

12. Revolving credit facility

	2010	2009
Secured revolving credit facility of up to \$230.0 million due February 11, 2012 with interest based on Canadian or U.S. Prime rates + 5%, or Canadian BA rates + 6%	\$ 106.5	\$ 152.6

Under the secured revolving credit facility, funds are available to the Company in Canadian and US dollars by way of adjusted Canadian bankers' acceptances plus 6%, or Canadian or U.S. prime rates plus 5% loans and letters of credit. This facility has been underwritten by a syndicate of banks and is due on February 11, 2012.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

12. Revolving credit facility (continued)

The facility includes financial covenants to maintain:

- a waiver of the minimum EBITDA for both 2010 and 2011, with the maximum availability under the line set at \$220.0 million for 2010 and \$215.0 million for 2011. So long as the Company generates minimum EBITDA of \$325,000 per quarter on a cumulative basis in 2011, then the maximum availability under the line will be increased to \$230.0 million for 2011;
- consolidated tangible net worth at the end of each quarter in excess of \$700.0 million;
- consolidated debt is less than 40% of capitalization;
- consolidated debt is less than 40% of the market value of the Company's private timberlands and higher use properties; and
- a permanent repayment provision which specifies that once cumulative real estate proceeds exceed \$50 million, 50% of additional proceeds will be applied to permanently reduce the facility size. The remaining 50% can be used by the Company to improve its liquidity. Current cumulative real estate proceeds are \$37.4 million.

On April 27, 2010, the Company completed an amendment to the bank loan agreement with its syndicate of banks. The amendment removed the requirement that the Company pay interest on its convertible debentures by issuing additional convertible debentures in lieu of cash. In connection with the amendment, the Company cannot make cash distributions on the Stapled Units unless its available cash exceeds, as defined in the Company's credit agreement, in the applicable year, the following thresholds: \$90.0 million in 2010; \$75.0 million in 2011; and \$75.0 million in 2012.

The complete terms of the revolving credit agreement and amendment are filed on SEDAR.

Bank EBITDA calculations include proceeds of real estate sales and other items. At December 31, 2010 the Company is in compliance with the terms of its revolving credit facility.

Transaction costs related to this refinancing have been deferred and capitalized on the balance sheet as they relate to debt refinancing held at amortized cost. The unamortized balance of these costs at December 31, 2010 was \$2.6 million (2009 - \$5.4 million). Amortization of deferred financing costs relating to the credit facility recognized in the consolidated statements of operation and comprehensive income (loss) for the year ended December 31, 2010 was \$2.8 million (2009 - \$1.9 million).

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

13. Convertible debentures

Details as to the Company's convertible debentures are as follows:

	Face Value	Fair Value
Balance, December 31, 2008	\$ -	\$ -
Year ended, December 31, 2009		
Change in value as a result of:		
Initial convertible debentures issuance, February 11, 2009	150.0	150.0
Interest paid in kind through issuance of convertible debentures	3.4	3.9
Change in fair value		53.9
Balance, December 31, 2009	\$ 153.4	\$ 207.8
Year ended, December 31, 2010		
Change in value as a result of:		
Interest paid in kind through issuance of convertible debentures	7.0	9.5
Conversions	(0.1)	(0.1)
Change in fair value		30.9
Balance, December 31, 2010	\$ 160.3	\$ 248.1

On February 11, 2009, the Company raised \$150 million by way of a 9% five-year convertible debenture issue. The convertible debentures mature on February 11, 2014 and are convertible into Stapled Units at \$3.50, subject to adjustments as provided under the conversion privilege. The convertible debentures pay interest quarterly at 9% per annum with the first interest payment made on April 15, 2009.

The Company has elected to designate this obligation as 'held-for-trading' and it is to be revalued at fair value at each reporting date. Changes in fair value from one period to the next are recognized in the statement of operations and comprehensive income (loss) in the period. For the year ended December 31, 2010 the change in fair value was \$32.3 million (2009 – \$55.6 million) (note 19(a)).

For the year ended December 31, 2010 the Company recorded interest expense of \$14.5 million. The Company paid interest of \$7.2 million in cash and \$3.5 million in kind by issuing convertible debentures with the balance accrued for at year end. For the year ended December 31, 2009 the Company recorded interest expense of \$11.9 million of which \$5.2 million was paid in cash, \$3.4 million was paid in kind by issuing convertible debentures with a face value of \$3.4 million, with the balance accrued for payment in kind on January 15, 2010 by issuing additional convertible debentures.

Transaction costs incurred on the issuance of the convertible debentures were expensed to the statement of operations and comprehensive income (loss). There were no transaction costs associated with the convertible debentures in 2010 (2009 - \$5.5 million).

Debentures with a face value of \$0.1 million were converted into 13,674 Stapled Units during the year ended December 31, 2010. Debentures with a face value of less than \$0.1 million were converted into 11,192 Stapled Units during the year ended December 31, 2009.

Subsequent to the year end, on January 17, 2011, the Company paid the July 15, 2009 deferred distribution on the Series A Subordinate Note of the Stapled Units by issuance of 785,854 additional Stapled Units. The terms of the convertible debenture trust indenture provide that the conversion privilege will be adjusted so that each debenture holder will be entitled to receive Stapled Units as if they had converted their convertible debentures into Stapled Units immediately prior to the deferred interest payment by issuance of Stapled Units. There is no adjustment to the conversion price unless the cumulative effect would change the conversion price by at least 1%.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

13. Convertible debentures (continued)

The cumulative effect on the conversion price of the April 15, 2009 and the July 15, 2009 deferred interest payments paid by issuance of Stapled Units on October 15, 2010 and January 17, 2011, respectively, is 1.8% and results in a conversion price adjustment from \$3.50 to approximately \$3.44.

14. Silviculture liability

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

	2010	2009
Silviculture liability, beginning of year	\$ 4.7	\$ 4.9
Expense for the year	2.2	1.0
Less: paid during the year	(1.1)	(1.2)
Silviculture liability, end of year	\$ 5.8	\$ 4.7
Current (included in accounts payable and accrued liabilities)	\$ 2.3	\$ 1.7
Long-term	3.5	3.0
	\$ 5.8	\$ 4.7

The total undiscounted amount of the estimated cash flows required to settle the Company's silviculture liability at December 31, 2010 was \$7.2 million (2009 – \$5.7 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 6.9% to 10.1%.

15. Employee future benefits

The Company maintains pension plans that include defined benefit (DB Plan) and defined contribution (DC Plan) segments available to all salaried employees. Employees are no longer eligible to join the DB Plan.

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 DB Plan was as of December 31, 2009 which determined the funded status of plan benefits and the funding requirements for the period from January 1, 2010 to December 31, 2012. This valuation identified a going-concern deficit of \$0.1 million and a solvency deficiency of \$0.3 million for the DB Plan. The Company's next required valuation for the DB Plan will be as of December 31, 2012.

The remaining DB Plan obligation relates to 3 members (2009 – 3 members) of the DB Plan. It is the Company's intention to annuitize these obligations using the DB Plan assets as each of the remaining DB Plan members leave active service with the Company. During the year, no members of the DB Plan retired. In 2009 one member of the DB Plan retired and \$0.5 million of pension assets and obligations were transferred to a financial institution to settle the benefit obligations for this retiring active member. The Company recorded a non-cash expense of \$0.1 million during 2009 related to this settlement, representing the unamortized net actuarial loss associated with the retiree pension obligations that would have otherwise been amortized over the expected life of the pension plan.

The Company also has a supplementary pension plan with no funding requirement. The Company funds the supplementary obligations as they are incurred.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

15. Employee future benefits (continued)

For the year ended December 31, 2010, the Company recorded an expense of \$1.5 million for pension benefit costs (2009 – \$1.7 million). The Company made cash payments contributing to the current service cost of \$1.6 million (2009 – \$1.5 million), \$0.1 million under the DB Plan (2009 – nil due to surplus), \$0.9 million (2009 – \$0.9 million) for benefit payments relating to the supplementary pension plan and \$0.6 million (2009 – \$0.6 million) for required contributions to the DC Plan. 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, 2010, the Company recorded an expense of \$1.8 million for non-pension benefit costs (2009 – \$2.4 million) and made cash payments of \$1.8 million to fund current benefit costs (2009 – \$2.1 million). During the year the Company made changes to the salaried non-pension post-retirement plan which triggered a past service event in accordance with CICA Section 3461, *Employee Future Benefits*, these changes decrease the accrued benefit obligation by \$7.2 million and is amortized over 12 years. The unamortized balance at December 31, 2010 is \$6.8 million.

Information about the Company's defined benefit plans other than the non-pension benefit plans, in aggregate, is as follows:

	Pension benefit plans		Non-pension benefit plans	
	2010	2009	2010	2009
Change in fair value of plan assets during the year:				
Fair value of plan assets, beginning of year	\$ 1.2	\$ 1.6	\$ -	\$ -
Actual return on plan assets	0.1	0.1	-	-
Employer contributions	1.0	0.9	1.8	2.1
Benefits paid	(0.9)	(0.9)	(1.8)	(2.1)
Settlement	-	(0.5)	-	-
Fair value of plan assets, end of year	1.4	\$ 1.2	-	-
Change in accrued benefit obligation during the year:				
Accrued benefit obligation, beginning of year	\$ 11.9	\$ 11.1	\$ 33.9	\$ 30.5
Current service cost	0.2	0.2	0.2	0.2
Interest cost	0.7	0.8	1.7	2.1
Benefits paid	(0.9)	(0.9)	(1.8)	(2.1)
Net actuarial (gain) loss	0.9	1.2	1.2	3.2
Plan changes	-	-	(7.2)	-
Settlement	-	(0.5)	-	-
Curtailment	-	-	-	-
Accrued benefit obligation, end of year	12.8	\$ 11.9	\$ 28.0	\$ 33.9
Reconciliation of funded status:				
Excess of accrued benefit obligation over plan assets	\$ (11.4)	\$ (10.7)	\$ (28.0)	\$ (33.9)
Unamortized net actuarial loss	2.0	1.1	7.3	6.4
Unamortized past service costs	-	-	(6.8)	-
Accrued liability at December 31	\$ (9.4)	\$ (9.6)	\$ (27.5)	\$ (27.5)

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, 2010, the plan assets were 100% invested in bonds. Securities held in the plans did not include any of the Company's Stapled Units or debentures.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

15. Employee future benefits (continued)

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

	Pension benefit plans		Non-pension benefit plans	
	2010	2009	2010	2009
Fair value of plan assets	\$ -	\$ -	\$ -	\$ -
Accrued benefit obligation	(11.4)	(10.7)	(28.0)	(33.9)
Plan deficit	\$ (11.4)	\$ (10.7)	\$ (28.0)	\$ (33.9)

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

	Pension benefit plans		Non-pension benefit plans	
	2010	2009	2010	2009
Current service costs – DB Plans	\$ 0.1	\$ 0.1	\$ 0.2	\$ 0.2
Interest cost	0.7	0.8	1.7	2.1
Expected return on plan assets	(0.1)	-	-	-
Amortization of experience loss	0.1	-	0.3	0.1
Amortization of past service cost	-	-	(0.4)	-
Settlement	-	0.1	-	-
Curtailement	-	-	-	-
	0.8	1.0	1.8	2.4
Current service cost – DC Plan	0.7	0.7	-	-
Expense recognized in the year	\$ 1.5	\$ 1.7	\$ 1.8	\$ 2.4

The cost of pension and other non-pension 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.

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		Non-pension benefit plans	
	2010	2009	2010	2009
Expense recognized in the year	\$ 1.5	\$ 1.7	\$ 1.8	\$ 2.4
Difference between net actuarial gains amortized and net actuarial gains arising	0.9	1.1	0.9	3.1
Difference between past service costs amortized and past service costs arising	-	-	(6.8)	-
Expense (recovery) incurred in the year	\$ 2.4	\$ 2.8	\$ (4.1)	\$ 5.5

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15. Employee future benefits (continued)

Weighted-average significant assumptions:

	Pension benefit plans		Non-pension benefit plans	
	2010	2009	2010	2009
Accrued benefit obligations:				
Discount rate	5.3%	6.0%	5.3%	6.0%
Rate of increase in future compensation	2.5%	3.0%	-	-
Net benefit expense:				
Discount rate	5.3%	6.0%	5.3%	6.0%
Assumed long-term rate of return on plan assets	4.0%	4.0%	-	-
Rate of increase in future compensation	2.5%	3.0%	-	-
Assumed health care cost trend at end of year:				
Initial health care cost trend	-	-	7.4%	8.2%
Annual rate of decline in trend rate	-	-	0.3%	0.4%
Ultimate health care cost trend rate	-	-	4.0%	4.4%

2010 sensitivity of significant assumptions:

	Change in obligation	Change in expense
Effect of 1% increase in health care cost trend rate	\$ 3.1	\$ 0.2
Effect of 1% decrease in health care cost trend rates	\$ (2.6)	\$ (0.2)

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, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

16. Stapled Units

(a) Authorized share capital:

10,069,608,359	Common shares without par value
1,600,000	Class A preferred shares
5,000,000	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
100,000,000	Series E preferred shares
25,000,000,000	Preferred shares with a par value of \$0.024456

(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 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.

On December 19, 2008 the holders of the Stapled Units approved a series of Note Amendments that came into effect on December 31, 2008. The Note Amendments are as follows: (i) the rate of interest on the Series A Subordinate Notes payable was changed from a fixed 12% per annum to a variable rate between 2% and 12% per annum to be set from time to time based on the Company's distributable cash; (ii) the period over which the Company can defer payments of interest on the notes was reduced from 27 months to 18 months, and the Company may only exercise this deferral right in respect of interest payments for periods where the applicable interest rate on the subordinate notes is 2%; and (iii) replaces the Company's right to elect to pay interest on the subordinate notes by delivering common shares or preferred shares of the Company with the right to elect to pay interest on the notes by delivering Stapled Units.

On May 18, 2010 the Company successfully raised \$60.0 million through a Stapled Unit public offering. The public offering was 12,000,000 Stapled Units at a price of \$5.00 per Stapled Unit for gross proceeds of \$60.0 million. As part of this issuance, transaction costs of \$3.2 million were deferred and offset against the Series A Subordinate Notes and are being amortized using the effective rate method over the life of the Series A Subordinate Notes until maturity.

The Series A Subordinate Notes are measured by the Company under GAAP at amortized cost under CICA Section 3855, *Financial Instruments – recognition and measurement*. As such, the balance of the Series A Subordinate Notes will be accreted using the effective interest rate method to face value of \$815.6 million to maturity. The Company recognized an accretion expense of \$7.4 million for the year ending December 31, 2010 (2009 – \$6.6 million).

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

16. Stapled Units (continued)

(b) Stapled Units (continued):

The option to defer interest distributions to the holders of the Stapled Units for up to 18 months is an embedded derivative under GAAP and is revalued at each reporting date. As at December 31, 2010, the fair value of this option is \$6.0 million (2009 – \$5.2 million) and is accounted for as Other Assets (note 10).

The option to extend the maturity date on the Series A Subordinate Notes from August 31, 2038 to August 31, 2048 is an embedded derivative under GAAP and is revalued at each reporting date. As at December 31, 2010 the fair value of this option is \$0.7 million (2009 - \$0.7 million) and is accounted for as Other Assets (note 10).

During the year ended December 31, 2010, the Company issued 13,054,802 Stapled Units (2009 – 11,192 Stapled Units). Details as to the 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, 2008	77,765,440	\$ 240.4	190.1	31.4	(30.5)	191.0	\$ 431.4
Year ended December 31, 2009:							
Issuance of Stapled Units on conversion of debentures	11,192	0.1	-	-	-	-	0.1
Accretion on Series A Subordinate Notes	-	6.6	-	-	-	-	6.6
Conversion of preferred shares into common shares	-	-	(190.1)	190.1	-	-	-
Balance, December 31, 2009	77,776,632	\$ 247.1	\$ -	\$ 221.5	\$ (30.5)	\$ 191.0	\$ 438.1
Year ended December 31, 2010:							
Issuance of Stapled Units upon:							
Public offering	12,000,000	56.3	-	0.5	-	0.5	56.8
Payment in kind (note 11)	885,447	3.5	-	-	-	-	3.5
Stapled Unit Option exercises (note 17(a))	155,681	0.7	-	-	-	-	0.7
Conversion of debentures (note 13)	13,674	0.1	-	-	-	-	0.1
Accretion on Series A Subordinate Notes	-	7.4	-	-	-	-	7.4
Balance, December 31, 2010	90,831,434	\$ 315.1	\$ -	\$ 222.0	\$ (30.5)	\$ 191.5	\$ 506.6

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(in millions of dollars, except per common share and per Stapled Unit amounts)

16. 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:

	Number of Notes	Amount
Balance, December 31, 2008	77,765,440	\$ 240.4
Year ended December 31, 2009:		
Issuance of Series A Subordinate Notes on conversion of debentures	11,192	0.1
Accretion on Series A Subordinate Notes		6.6
Balance, December 31, 2009	77,776,632	247.1
Year ended December 31, 2010:		
Issuance of Series A Subordinate Notes upon:		
Public offering	12,000,000	56.3
Payment in kind (note 11)	885,447	3.5
Stapled Unit Option exercises (note 17(a))	155,681	0.7
Conversion of debentures (note 13)	13,674	0.1
Accretion on Series A Subordinate Notes	-	7.4
Balance, December 31, 2010	90,831,434	\$ 315.1

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 between \$0.179576131 and \$1.077456788 per annum (2-12%).

The Series A Subordinate Notes are unsecured and subordinate to the revolving credit facility (see note 12) and convertible debentures (note 13). 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.

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(in millions of dollars, except per common share and per Stapled Unit amounts)

16. Stapled Units (continued)

(b) Stapled Units (continued):

(ii) Preferred shares:

	Number of shares	Amount
Balance, December 31, 2008	7,776,544,000	\$ 190.1
Year ended December 31, 2009:		
Conversion of preferred shares into common shares	(7,776,544,000)	(190.1)
Balance, December 31, 2009	-	-
Balance, December 31, 2010	-	\$ -

On May 7, 2009 the Company's preferred shares were converted into common shares and consolidated in order to simplify TimberWest's capital structure and eliminate administrative burdens and related expenses associated with maintaining the preferred shares. Each TimberWest Stapled Unit contains one Series A Subordinate Note and one common share. The conversion and consolidation was approved by the unitholders on May 6, 2009 and was approved by the Toronto Stock Exchange ("TSX").

(iii) Common shares:

	Number of shares	Amount
Balance, December 31, 2008	77,765,440	\$ 31.4
Year ended December 31, 2009:		
Common shares issued on conversion of debentures	11,192	-
Conversion of preferred shares into common shares	-	190.1
Balance, December 31, 2009	77,776,632	221.5
Year ended December 31, 2010:		
Issuance of Common shares upon:		
Public offering	12,000,000	0.5
Payment in kind (note 11)	885,447	-
Stapled Unit Option exercises (note 17(a))	155,681	-
Conversion of debentures (note 13)	13,674	-
Balance, December 31, 2010	90,831,434	\$ 222.0

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

16. Stapled Units (continued)

(c) Class B preferred shares issuable in series:

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

	Number of shares	Amount
Series E		
Preferred shares outstanding, December 31, 2009	92,000,000	\$ 920.0
Preferred shares owned by the Company's subsidiaries	(92,000,000)	(920.0)
Balance, December 31, 2009	-	-
Preferred shares outstanding, January 1, 2010	92,000,000	920.0
Preferred shares cancelled by Company's subsidiaries	(92,000,000)	(920.0)
Balance, December 31, 2010	-	\$ -

During 2010, 92,000,000 Series E Class B preferred shares were cancelled on amalgamation with the Company's subsidiary company.

17. Stapled Unit Option Plan

(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 7,000,000 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.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

17. Stapled Unit Option Plan (continued)

(a) Stapled Unit Option Plan (continued):

Activity in the Company's Stapled Unit Option Plan for fiscal 2010 and 2009 was as follows:

	2010		2009	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Options outstanding, beginning of year	2,537,745	\$ 6.67	1,240,326	\$ 12.85
Granted	880,047	5.21	1,719,327	3.01
Exercised	(155,681)	3.04	-	-
Cancelled	(40,000)	4.67	(186,803)	5.88
Expired	(327,611)	14.90	(235,105)	13.19
Options outstanding, end of year	2,894,500	\$ 5.51	2,537,745	\$ 6.67

A summary of Stapled Unit options outstanding at December 31, 2010, 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	
34,261	\$ 2.61	\$ 2.61	3.2	11,420	\$ 2.61	
1,392,838	3.01	3.01	3.1	365,481	3.01	
31,250	4.14	4.14	4.5	-	4.14	
823,797	5.25	5.25	4.2	-	5.25	
215,725	5.45	5.45	2.9	143,818	5.45	
176,730	13.94	13.94	0.1	176,730	13.94	
300	14.71	14.71	1.8	300	14.71	
209,599	16.26	16.26	1.1	209,599	16.26	
3,000	16.64	16.64	1.5	3,000	16.64	
6,000	17.20	17.20	1.3	6,000	17.20	
1,000	17.78	17.78	2.5	1,000	17.78	
2,894,500	\$ 2.61-17.78	\$ 5.51	3.1	917,348	\$ 8.68	

The option to acquire a Stapled Unit effectively provides the option holder with an option on the Series A Subordinated Note component and an option on the equity component of the Stapled Unit. An option to acquire a debt instrument is accounted for under the intrinsic value method whereby the compensation cost is determined each period based on the fair value of the debt instrument compared to the exercise price of the option to acquire the debt instrument. The fair value of the equity component is based on the fair value of the option as determined using an option pricing model. Historically, the Company has determined that the intrinsic value of the option to acquire the Series A Subordinate Notes has not been material and the fair value of the option has been recorded in equity as contributed surplus based on the fair value as determined by the Black Scholes option pricing model.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

17. Stapled Unit Option Plan (continued)

(a) Stapled Unit Option Plan (continued):

With the recent changes to the Series A Subordinate Note terms including modifying the interest rate to a variable rate from 2% to 12% which is ultimately based on distributable cash levels and the current market value of the Stapled Unit which is below the face value of the Series A Subordinate Note, the Company has determined that the value of the Stapled Unit option is now in the debt component and that the equity option value is immaterial. As a result, the accounting for the options issued since January 1, 2009 year has been done using the intrinsic value method.

On this basis the compensation cost for the 2,282,146 Stapled Unit options granted since January 1, 2009 and outstanding as at December 31, 2010, based on an intrinsic value method of accounting, for the year ended December 31, 2010 was \$0.2 million (2009 - \$1.5 million). A corresponding amount was expensed in the period with a corresponding credit to the Stapled Unit option plan liability.

(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.

Awards are accrued on a basis equal to actual distributions paid on the Company's issued and outstanding Stapled Units and are charged to earnings as the underlying Stapled Unit options vest. For the year ended December 31, 2010, \$0.1 million was accrued (2009 – no amount was accrued as no distributions were paid) and \$0.1 million has been amortized against earnings (2009 – \$0.1 million).

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

18. Commitments and contingencies

(a) Operating leases:

At December 31, 2010, the Company was committed to payments under operating leases for equipment and office premises in the amount of approximately \$4.0 million. Annual payments over the term of these commitments are as follows:

2011	\$	0.7
2012		0.6
2013		0.6
2014		0.3
2015		0.3
2016+		1.5
Total operating lease commitments		\$ 4.0

(b) Letters of credit:

At December 31, 2010, the Company had commitments of \$14.5 million (2009 – \$16.4 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.

19. Financial instruments

(a) Fair values:

The carrying values of accounts receivable, accounts payable and accrued liabilities included on the consolidated balance sheet approximate their fair values due to the short term to maturity of these instruments.

The carrying value of drawings on the revolving credit facility included on the consolidated balance sheet approximate fair value, as it has a floating interest rate that approximates market rates and has a short term to maturity.

The carrying value of accrued liabilities for future silviculture costs included on the consolidated balance sheet approximate fair value as it is determined based on the present value of future cash flows associated with these liabilities.

The distributions payable of \$47.1 million accrued at the end of 2010 can be deferred (note 11) and as such has been fair valued at \$45.2 million based on the present value of the future disbursement.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

19. Financial instruments (continued)

(a) Fair values (continued):

The Series A Subordinate Notes have been measured by the Company under GAAP at amortized cost under CICA Section 3855, *Financial Instruments – recognition and measurement*. As such, the balance of the Series A Subordinate Notes will be accreted using the effective interest method. During 2010, \$7.4 million was recognized as accretion on the Series A Subordinate Notes (2009 – \$6.6 million).

The Series A Subordinate Notes are a component of the Company's Stapled Units, which include one common share and approximately \$8.98 face amount of the Series A Subordinate Notes. The Stapled Units are listed on the Toronto Stock Exchange. The embedded derivative arising from the option to extend the Series A Subordinate Notes for a further 10 year period from 2038 to 2048 is measured at fair value. The fair value of this option is determined by an independent financial firm and is measured based on level 2 inputs. The embedded derivative arising from the option to defer the payment of distributions to unitholders for up to 18 months is measured at fair value based on level 2 inputs.

The convertible debentures have been designated by the Company as 'held-for-trading' and are to be revalued at fair value at each reporting date. Changes in fair value from one period to the next are recognized in the statement of operations and comprehensive income (loss) in the period. From January 1, 2010 the public convertible debentures are considered to trade in an active market and accordingly, fair value is measured based on level 1 inputs. The fair value of the private convertible debentures continues to be measured based on level 2 inputs, as there is no active market for trading.

Details as to the changes in fair value of financial instruments held for trading for the year ended December 31, 2010 as recognized in the statement of operations and comprehensive income (loss) are as follows:

(in millions of dollars)	2010	2009
Change in fair value of:		
Convertible debentures	\$ 30.9	\$ 53.9
Interest payable in kind on the convertible debentures	1.4	1.7
Embedded derivatives within the Series A Subordinate Notes	(0.8)	(1.2)
Change in fair value of financial instruments held for trading	\$ 31.5	\$ 54.4

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

19. Financial instruments (continued)

(b) Credit risk:

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. The Company is exposed to credit risk on accounts receivable from customers. To mitigate and manage its credit risk, the Company regularly reviews customer credit limits, monitors the financial status of customers, and assesses the collectability of accounts receivable. In certain offshore markets, the Company requires bank letters of credit or letters of assignment. The maximum exposure to credit risk as at December 31, 2010 is the carrying value of the Company's accounts receivable. As at December 31, 2010, substantially all of the Company's accounts receivable are current or outstanding for less than 30 days.

(c) Market risk:

Market risk refers to the risk of loss that may arise from changes in market factors such as interest rates, and foreign exchange rates.

Interest rate risk refers to the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates.

TimberWest has one revolving credit facility as at December 31, 2010. Under this facility, funds are available to the Company in Canadian and US dollars by way of adjusted Canadian bankers' acceptances plus 6%, or Canadian or U.S. prime rates plus 5% loans and letters of credit. This facility has been underwritten by a syndicate of banks and is due on February 11, 2012.

The Company normally enters into Bankers' Acceptance for less than 30-day periods for the revolving credit facility and could therefore be exposed to fluctuations in interest rates at the Bankers' Acceptance expiration.

For the year ended December 31, 2010, with all other variables unchanged, an interest rate change of 1% per annum related to the revolving credit facility would affect net earnings by approximately \$1.1 million.

Foreign exchange risk refers to the risk that the fair value or future cash flow of a financial instrument will fluctuate because of changes in foreign exchange rate.

The majority of TimberWest's sales are in markets outside of Canada and denominated in US dollars (65% of revenue in 2010). 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 Japanese yen, European euro, and the Russian ruble also affect the Company's competitiveness in the markets where it sells its products. TimberWest does not hedge its foreign exchange risk.

Cash, accounts receivable, and accounts payable are denominated in Canadian dollars. As at December 31, 2010, with other variables unchanged, the effect of a \$0.01 US change per Canadian dollar on cash, accounts receivable, and accounts payable would be less than \$0.1 million.

Notes to Consolidated Financial Statements

Years Ended December 31, 2010 & 2009

(in millions of dollars, except per common share and per Stapled Unit amounts)

19. Financial instruments (continued)

(d) Liquidity risk:

Liquidity risk refers to the risk that TimberWest may be unable to generate or obtain sufficient cash or cash equivalents in a timely and cost-effective manner to meet its commitments as they come due.

The Company manages liquidity risk by continuously monitoring and reviewing both actual and forecasted cash flows to maintain adequate cash and cash equivalent balances.

The following table provides a summary of the contractual undiscounted cash flow requirements for certain financial liabilities as at December 31, 2010. This table details payments due in each of the next five years and thereafter for the Company's revolving credit facility, convertible debentures, and outstanding letters of credit:

(in millions of dollars)	2011	2012	2013	2014	2015	2016+	Total
Reflected on the consolidated balance sheets:							
Revolving credit facility	\$ -	\$ 106.5	\$ -	\$ -	\$ -	\$ -	\$ 106.5
Convertible debentures	-	-	-	160.3	-	-	160.3
	-	106.5	-	160.3	-	-	266.8
Not reflected on the consolidated balance sheets:							
Outstanding letters of credit	14.5	-	-	-	-	-	14.5
	\$ 14.5	\$ 106.5	\$ -	\$ 160.3	\$ -	\$ -	\$ 281.3

Letters of credit are committed in perpetuity, renew annually and the liability will diminish over time.

Available capital resources and total liquidity at year-end is summarized in the following table:

(in millions of dollars)	2010	2009
Borrowing base		
Revolving credit facility (due February 11, 2012)	\$ 220.0	\$ 220.0
Convertible debentures, at face value (due February 11, 2014)	160.3	153.4
Total borrowing base	380.3	373.4
Letters of credit	14.5	16.4
Amount drawn, net	266.8	306.0
Available to be drawn	99.0	51.0
Cash on hand	3.5	1.8
Total liquidity	\$ 102.5	\$ 52.8

20. Subsequent event

Subsequent to year end, on February 9, 2011, the Company has agreed to acquire 7,678 hectares of private timberland located adjacent to the Company's existing private timberlands on southern Vancouver Island from Western Forest Products Inc. The purchase price is \$21.9 million and will be funded through the Company's existing credit facility. Closing is subject to customary conditions.