



**1<sup>st</sup> Quarter**  
INTERIM REPORT

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For the three months  
ended March 31, 2004

maintaining our  
**FOCUS**

GROWING GREATEST VALUE THROUGH OPERATIONS EXCELLENCE

# TIMBERWEST FOREST CORP.

## To Our Unitholders,

I am pleased to report the Company had a strong start to the 2004 fiscal year. Despite a \$25 million or 20% reduction in sales revenue compared to this time last year, margins improved because of lower unit costs of production for both timberland and manufacturing operations. In fact, compared to the same quarter last year our overall operating margin improved by 14%.

TimberWest generated distributable cash of \$27.7 million or \$0.36 per Stapled Unit for the first quarter, compared to distributable cash of \$25.7 million or \$0.34 per Stapled Unit for the same period in 2003. This improvement in distributable cash is the result of strong earnings and lower capital spending, offset in part by fewer property sales in the current year period.

Timberland Operations also continue to drive down the unit cost of production as part of our ongoing Operations Excellence strategy. Despite a less favourable exchange rate and lower average log sales realizations, the Company generated more distributable cash in Q1 2004 than in Q1 2003 on less sales volume.

In addition, on its public land business, the Company gained approval for a significant portion of second-growth cutting permits before the BC Government implemented its market-based timber pricing system (MPS) for coastal BC. TimberWest supports the government's move towards MPS, as being able to respond to markets is critical to the competitiveness of the BC Coast. As the number of timber sales increase with the expanded BC timber sales program, a representative, bias-free data set will develop, leading to market-driven value for timber.

We also started the year with a relatively high-value mix of inventory as the result of our decision at the end of 2003 to carry some volume into 2004 to capture higher anticipated market values.

First quarter logs sales realizations of \$105 per m<sup>3</sup> compared very favourably with the \$91 per m<sup>3</sup> for the previous quarter, but were lower than last year's first quarter of \$113 per m<sup>3</sup>. As previously mentioned, the exchange rate began to move against us late in the first quarter of last year. The average exchange rate for the first quarter of 2004 was \$1.32CAD/US compared to \$1.51CAD/US in Q1 2003.

Log sales volumes for the quarter were 18% lower than the comparative quarter in 2003 due in part to a low opening inventory. Log inventory at the start of 2004 was 180.0 thousand m<sup>3</sup> lower than log inventory at the start of 2003.

We are pleased that the Elk Falls Lumbermill was cash and earnings positive for the quarter, after being assessed the international price for logs. On the real estate side, the Company is behind its first quarter 2003 pace but this is a matter of timing. We expect real estate earnings to be normal for the year, with the market flat to improving. Finally, the Company's capital expenditures were lower in the first quarter of 2004 relative to the first quarter in 2003.

I am also pleased to announce TimberWest's next quarterly distribution of \$0.269 per Stapled Unit, payable on July 15, 2004, to unitholders of record on July 1, 2004. Since TimberWest's inception in July 1997, including the distribution paid on April 15, 2004, the Company has distributed in excess of \$504 million to its unitholders.

In addition, I am pleased to report that the CFO and I have certified the quarterly financial statements of TimberWest, having implemented an internal certification process. Our financial statements and certification will be filed with SEDAR.

Looking beyond the financials, the Company continues to show steady improvement in health and safety performance. Timberland Operations has a year-to-date MIR rating of 2.96, compared to 3.97 for the first quarter last year, and Elk Falls has an MIR of 1.69 versus last year's MIR of 2.56.

In terms of labour, we expect Donald Munroe, the mediation-arbitration Commissioner appointed by the provincial government in December 2003, to issue his binding award by the end of May. Given that his terms of reference called upon him to consider the need for terms and conditions of employment that are "consistent with the economic viability and competitiveness of the coastal forest industry in both the short- and long-term, the importance of good labour-management relations, and the interests of the employees and trade unions," decisions of the Commissioner could have a substantial effect on the viability and competitiveness of the Coastal industry.

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## TIMBERWEST FOREST CORP.

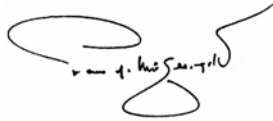
The softwood lumber dispute with the US continues unresolved. We were encouraged by NAFTA ruling that US lumber producers have not suffered serious injury from Canada's annual exports. The NAFTA panel ruling said the US International Trade Commission's original finding that Canada's softwood exports posed a serious threat of injury 'is not supported by substantial evidence.' While this is positive, we believe it is imperative to get resolution as quickly as possible and negotiation is still the best route for that. We were pleased that, while in Vancouver last month, Grant Aldonas, the US Commerce Undersecretary, said that an alternative approach to settling this dispute on a nation-wide basis may be for the US to strike a separate agreement with British Columbia. He cited BC's policy reforms and progress in establishing a market-based timber pricing system as the basis for such a deal. We understand exploratory discussions are underway between the government of BC and the US Department of Commerce to determine whether a BC-first deal is possible. We remain hopeful that true market forces will be brought to bear throughout the industry, including on the private land log side.

Looking ahead, while we expect to deliver a good second quarter, and generate sufficient distributable cash from operations for the year. We are concerned about forecasts of a long, hot summer that could result in logging curtailments, and about increasing ocean freight rates that will impact revenues from log and lumber exports. We are also concerned about the impact on pricing from the potential for significant volumes of old-growth hemlock and fir coming into the market as coastal logging picks up given the reduction in stumpage rates on old-growth harvests under MPS. And, of course, there is the ongoing uncertainty caused by the lack of resolution to the softwood lumber dispute with the US and the restriction on our ability to export logs to Japan and the US.

We will continue to focus on cost reduction and working safely.

Thank you for your continued support.

On behalf of the Board of Directors



Paul J. McElligott  
President and Chief Executive Officer

Vancouver, British Columbia  
April 29, 2004

# TIMBERWEST FOREST CORP.

## Management's Discussion and Analysis

### For the three months ended March 31, 2004 and 2003

Management's discussion and analysis supplements, but does not form part of, the unaudited interim consolidated financial statements of TimberWest Forest Corp. ("TimberWest" or "the Company") and the notes thereto for the first quarter of 2004. This discussion and analysis provides an overview of significant developments that have affected TimberWest's performance during the first quarter of 2004 relative to the first quarter of 2003, and that have affected the Company's financial position as at March 31, 2004, relative to December 31, 2003. 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 the Company to be materially different than those expressed or implied in this discussion. These risks and uncertainties are described herein and in the management's discussion and analysis contained in the Company's 2003 Annual Report.

This management's discussion and analysis has been prepared based on information available as at April 20, 2004. Additional information relating to TimberWest, including the Company's most recent 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>.

### Distributable Cash

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

	Three months ended March 31, 2004	Three months ended March 31, 2003
Net earnings	\$ 17.1	\$ 17.7
Income tax benefit related to distributions	7.3	7.7
Earnings available for distribution	24.4	25.4
Future income tax expense (recovery)	(0.8)	0.9
Earnings available for distribution before provision for future income taxes	23.6	26.3
Add (deduct):		
Depreciation, depletion and amortization	3.2	3.0
Proceeds from sale of property, plant and equipment	1.4	3.1
Gain on sale of property, plant and equipment	(0.5)	(1.0)
Additions to property, plant and equipment	(0.5)	(7.5)
Other non-cash items	0.5	1.8
	4.1	(0.6)
Distributable cash	\$ 27.7	\$ 25.7
<i>Basic earnings available for distribution before provision for future income taxes per weighted average Stapled Unit</i>	<i>\$ 0.31</i>	<i>\$ 0.35</i>
<i>Diluted earnings available for distribution before provision for future income taxes per weighted average Stapled Unit</i>	<i>\$ 0.31</i>	<i>\$ 0.34</i>
<i>Basic and diluted distributable cash per weighted average Stapled Unit</i>	<i>\$ 0.36</i>	<i>\$ 0.34</i>
<i>Cash distributions paid per Stapled Unit</i>	<i>\$ 0.27</i>	<i>\$ 0.27</i>

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

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Distributable cash and earnings available for distribution are measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles (GAAP) and may not be comparable to similar measures presented by other companies. Management believes that the presentation of these measures will enhance an investor's understanding of the Company's operating performance. A reconciliation of net earnings as determined in accordance with GAAP and both earnings available for distribution and distributable cash is provided in the preceding table.

The following tables present a quarterly comparison of distributable cash generated, in total and on a per Stapled Unit basis:

	2004	2003	2002	2001	2000	1999	1998
<b>Distributable Cash</b>							
<i>(in millions of dollars)</i>							
First	\$ 27.7	\$ 25.7	\$ 21.2	\$ 25.9	\$ 28.4	\$ 24.5	\$ 13.2
Second		4.7	10.6	26.7	28.2	25.1	24.0
Third		12.0	34.1	14.1	14.1	14.0	11.5
Fourth		9.0	24.2	16.8	18.5	19.7	19.6
	\$ 27.7	\$ 51.4	\$ 90.1	\$ 83.5	\$ 89.2	\$ 83.3	\$ 68.3
<b>Distributable Cash per Stapled Unit</b>							
<i>(in dollars)</i>							
First	\$ 0.36	\$ 0.34	\$ 0.30	\$ 0.40	\$ 0.41	\$ 0.36	\$ 0.19
Second		0.06	0.14	0.41	0.42	0.36	0.34
Third		0.15	0.45	0.22	0.22	0.20	0.17
Fourth		0.12	0.32	0.26	0.29	0.28	0.28
	\$ 0.36	\$ 0.67	\$ 1.21	\$ 1.29	\$ 1.34	\$ 1.20	\$ 0.98

## Quarterly Financial Highlights

TimberWest generated distributable cash of \$27.7 million or basic and diluted distributable cash of \$0.36 per weighted average Stapled Unit for the quarter ended March 31, 2004, compared to distributable cash of \$25.7 million or basic and diluted distributable cash of \$0.34 per weighted average Stapled Unit for the same period in 2003. The increase in distributable cash from the prior year reflects the net effect of lower capital expenditures in the first quarter of 2004 relative to the first quarter in 2003, offset in part by lower net earnings and lower proceeds on the sale of property, plant and equipment in the first quarter of 2004 compared to the same period in 2003. Earnings available for distribution for the first quarter of 2004, before provision for future income taxes, were \$23.6 million or \$0.31 per basic and diluted weighted average Stapled Unit compared to \$26.3 million or \$0.35 per basic and \$0.34 per diluted weighted average Stapled Unit for the same quarter in 2003. Net sales for the first quarter of 2004 were \$101.6 million compared to net sales of \$126.6 million reported for the first quarter of 2003. Operating earnings were \$28.0 million for the first quarter of 2004 compared to \$30.5 million for the same period in 2003, representing a 14% margin improvement compared to the first quarter of 2003. Earnings before interest, taxes, depreciation and amortization (EBITDA)<sup>1</sup> for the quarter ended March 31, 2004, were \$31.1 million or \$0.41 per basic and diluted weighted average Stapled Unit compared to \$33.5 million or \$0.44 per basic and diluted weighted average Stapled Unit for the same period in 2003. Net earnings for the quarter ended March 31, 2004 were \$17.1 million or basic and diluted net earnings of \$0.05 per weighted average common share, compared to net earnings of \$17.7 million or basic and diluted net earnings of \$0.06 per weighted average common share for the same period in 2003.

On January 21, 2004, the Company signed a definitive agreement for the sale of its southern Vancouver Island public land operations, referred to as Tree Farm Licence 46 (TFL 46). The sale is scheduled to close

<sup>1</sup> EBITDA is a measure that does not have a standardized meaning prescribed by Canadian generally accepted accounting principles (GAAP) and may not be comparable to similar measures presented by other companies. Management believes that the presentation of this measure will enhance an investor's understanding of the Company's operating performance. A reconciliation of net earnings as determined in accordance with GAAP and EBITDA is provided in the supplemental information appended to this interim report.



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in early May 2004. Sale proceeds on this transaction are expected to exceed the carrying value of the assets being disposed of and will be included in distributable cash. Additional information on this transaction is provided under "Sale of TFL 46" in this management's discussion and analysis.

On March 2, 2004, the Company completed and received a renewal of short-term financing from a Canadian bank. The renewed financing consists of an unsecured demand bank guarantee facility in the amount of \$16.0 million and an unsecured 364-day committed revolving facility in the amount of \$40.0 million that is due on March 1, 2005. Under the 364-day facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate based loans, Canadian dollar bankers' acceptances and letters of credit or guarantee.

### **Sale of TFL 46**

On January 21, 2004, the Company signed a definitive agreement for the sale of its southern Vancouver Island public land operations, referred to as TFL 46. The decision to sell TFL 46 was announced late in the third quarter of 2003 and the sale was undertaken through an auction process with qualified bidders. TFL 46 represents part of the Company's public land logging business, includes timber rights to an annual allowable cut of 499,000 m<sup>3</sup> on 76,574 hectares of Crown land, and has been operated by TimberWest as part of its Honeymoon Bay operation on southwest Vancouver Island.

The decision to offer TFL 46 for sale was based on a strategic review of the Company's portfolio of assets and a focus on maximizing returns to unitholders. TimberWest's core business is its private timberlands – for other companies, owning and operating a Tree Farm Licence is a core business strategy, therefore they may place a higher value on TFL 46. With recent policy changes around the sale of tenures and other forest policy reforms in British Columbia, TimberWest believed an opportunity existed to realize better value for unitholders from TFL 46 by selling it.

All conditions for closing have been removed and the transaction is scheduled to complete in early May 2004.

### **Cash Distribution**

On April 29, 2004, TimberWest announced a distribution of \$0.269 per Stapled Unit, payable July 15, 2004, to unitholders of record on July 1, 2004. From inception to March 31, 2004, the Company has generated distributable cash of \$499.3 million while, including the April 15, 2004 distribution of \$20.6 million, the Company has paid out \$504.9 million to unitholders.

Due to the seasonal and cyclical nature of TimberWest's business, cash flows may fluctuate from quarter to quarter and from year to year. One of the objectives of TimberWest's cash distribution policy is to make even distributions to unitholders, which may differ from actual cash generated during the period.

### **Operating Highlights**

Log sales for the three months ended March 31, 2004, were \$79.3 million, down 24% from log sales of \$103.8 million for the quarter ended March 31, 2003. This decrease reflects an 18% drop in the volume of logs sold, with 753.0 thousand m<sup>3</sup> sold in the first quarter of 2004 compared to 919.4 thousand m<sup>3</sup> sold in the first quarter of 2003, and a 7% decrease in overall log sales realizations for the quarter, down to \$105 per m<sup>3</sup> from \$113 per m<sup>3</sup> for the comparative quarter in 2003. Sales to domestic market customers were down 15%, reflecting a 12% decrease in log sales volume, down to 501.1 thousand m<sup>3</sup>, and a 4% decrease in realizations, down to \$91 per m<sup>3</sup>. Export sales were down 33%, reflecting a 29% decrease in log sales volume to 251.9 thousand m<sup>3</sup> and a 6% decrease in realizations to \$133 per m<sup>3</sup>. Canadian dollar realizations have begun to regain ground since the end of 2003 and pricing in all end markets has improved during the quarter. Currency is still a factor in comparing the first quarter of 2004 with the first quarter of 2003 as the Canadian dollar was 15% stronger during the first quarter of 2004 relative to the comparative quarter in 2003. However, these effects have been mitigated to some extent by improvement in the end-use sort mix, with the sales mix for the first quarter of 2004 comprised of 64% fir, 16% hembal and 11% cedar, compared to 54% fir, 24% hembal and 13% cedar for the comparative period in 2003. This result can be attributed in part to the fact that the Company carried a higher-value inventory into the first quarter of 2004.

The operating margin from timberland operations for the first quarter of 2004 averaged 39% of log sales compared to 33% for the first three months of 2003. Production costs for the quarter were \$61 per m<sup>3</sup> compared to \$71 per m<sup>3</sup> for the first quarter of 2003, reflecting the effects of lower production, stumpage and



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transportation costs compared to the prior year period. Logging production volumes for the first quarter of 2004 were up 3% over the comparative period in 2003, to 919.7 thousand m<sup>3</sup>, with increased harvests from both public and private lands.

Lumber sales for the quarter ended March 31, 2004, of \$17.6 million were up 6% over sales of \$16.6 million for the comparative quarter in 2003. This improvement reflects a combination of improved lumber sales realizations for the quarter, rising 3% to \$549 per mfbm from \$532 per mfbm for the comparative period in 2003, and a 3% increase in the volume of lumber sold, rising to 32.0 million board feet for the quarter from 31.1 million board feet for the first quarter of 2003. Production at the lumbermill was up 13% over the comparative quarter in 2003 to 40.2 million board feet, reflecting the benefits of a number of factors including the addition of a third shift in 2003, capital improvements, and the effectiveness of the preventative maintenance program.

Real estate activity for the first quarter of 2004 generated revenues of \$0.9 million compared to revenues of \$2.6 million for the first quarter of 2003, reflecting fewer transactions closing in the current year period compared to the first quarter of 2003.

### Financial Position

Current assets increased \$25.2 million to \$95.3 million at March 31, 2004, from \$70.1 million as at December 31, 2003. This variance can be attributed to an increase in accounts receivable of \$10.2 million, and an overall increase in inventories of \$13.9 million during the first quarter of 2004, with log inventories increasing \$9.2 million to \$50.3 million and lumber inventory increasing \$4.8 million to \$7.9 million. Labour-related work stoppages on timberland operations during November and December 2003 and market-related curtailments at the lumbermill during December 2003 resulted in reduced production and lower sales activity due to limited product available for sale during the last part of the fourth quarter of 2003, contributing to accounts receivable and inventory balances being considerably lower than typical for fiscal year end. Increased production and sales during the first quarter of 2004 relative to the fourth quarter of 2003 have resulted in accounts receivable and inventory balances being restored to more normal levels.

Property, plant and equipment of \$1,353.4 million as at March 31, 2004, was \$3.1 million less than at December 31, 2003, reflecting the current quarter provision for depreciation, depletion and amortization of \$2.9 million and the sale of property, plant and equipment in the quarter for proceeds of \$1.4 million, partially offset by \$0.5 million in additions to property, plant and equipment during the quarter.

Other assets were \$14.0 million at March 31, 2004, down slightly from \$14.3 million at December 31, 2003. Other assets are comprised primarily of prepaid pension benefits and deferred debt issue costs.

Current liabilities at the end of the first quarter of 2004 were \$126.1 million, up \$16.1 million from \$110.0 million as at December 31, 2003. Accounts payable and accrued liabilities increased \$23.0 million during the first quarter, to \$52.5 million at March 31, 2004. Similar to accounts receivable and inventory balances, accounts payable and accrued liabilities were at less than normal levels at December 31, 2003, due to production-related curtailments late in the fourth quarter of 2003 and lower stumpage fee accruals due to reduced harvests on Crown tenures during the fourth quarter of 2003. Increased production in the first quarter of 2004 has resulted in accounts payable and accrued liabilities increasing to more typical levels as at March 31, 2004. The distribution payable at the end of the first quarter of 2004 of \$20.6 million is up slightly from the distribution payable at December 31, 2003, reflecting a consistent per unit distribution and an increase in the number of Stapled Units outstanding at the end of the quarter due to the exercise of Stapled Unit options.

On March 2, 2004, the Company completed and received a renewal of short-term financing from a Canadian bank in the amount of \$40.0 million pursuant to an unsecured 364-day committed revolving facility due on March 1, 2005. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate based loans, Canadian dollar bankers' acceptances and letters of credit or guarantee. As at March 31, 2004, the Company had borrowings of \$53.0 million on its two \$40.0 million unsecured 364-day revolving facilities, a decrease of \$7.0 million from borrowings of \$60.0 million at December 31, 2003, which partially offset increases in the other current liability items.

As at March 31, 2004, long-term credit facilities available to the Company consisted of an unsecured revolving credit facility for \$125.0 million and due on June 30, 2006. There were no borrowings on this facility at March 31, 2004, or at December 31, 2003. Long-term liabilities as at March 31, 2004, included

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\$195.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007, a silviculture liability of \$4.9 million, a \$25.8 million liability relating to non-pension post retirement benefits and a future income tax liability of \$229.7 million. These liabilities have not changed materially from balances reported at December 31, 2003.

During the quarter ended March 31, 2004, 313,220 Stapled Unit options were granted and options to purchase 150,200 Stapled Units were exercised for proceeds of \$1.9 million. As at April 20, 2004, the Company had 1,671,753 granted and outstanding Stapled Unit option awards and 76,406,322 issued and outstanding Stapled Units.

### Cash Flow and Liquidity

Net cash generated from operations before changes in non-cash working capital for the three months ended March 31, 2004, was \$27.0 million or \$0.35 per basic and diluted weighted average Stapled Unit compared to \$28.3 million or \$0.37 per basic and diluted weighted average Stapled Unit for the corresponding quarter in 2003. During the first quarter of 2004, non-cash working capital increased by \$2.2 million compared to a \$5.9 million increase reported for the same period in 2003. The increase for the first quarter of 2004 reflects an increase in accounts receivable and higher inventory levels, offset in part by higher accounts payable and accrued liabilities at the end of the first quarter relative to December 31, 2003. As noted previously, reduced production late in the fourth quarter of 2003 resulted in reductions to accounts receivable, inventories and accounts payable and accrued liabilities to levels lower than typical at the end of the fiscal year. The increase for the comparative period reflects an increase in inventory levels and accounts receivable balances to seasonal levels for the end of the first quarter in the prior year.

Net cash used for financing activities during the first quarter of 2004 was \$25.6 million compared to \$19.9 million used for financing activities in the comparative period of 2003. Financing cash flows for the three months ended March 31, 2004, included the payment of the first quarter distribution to unitholders of \$20.5 million, which was comparable to the distribution paid in the first quarter of 2003, and net repayments during the quarter of \$7.0 million on borrowings on credit facilities. During the three months ended March 31, 2004, the Company issued 150,200 Stapled Units for net proceeds of \$1.9 million on the exercise of Stapled Unit options. This compares to \$0.4 million received on the exercise of options for 46,667 Stapled Units in the comparative period of 2003. During the first quarter of 2003, the Company retired \$106.5 million aggregate principal amount of 6.5% debentures when they matured on March 3, 2003. The retirement of these debentures was funded from drawings on revolving credit facilities available to the Company at that time.

Net cash provided by investing activities during the first quarter of 2004 was \$0.8 million compared to net cash used in investing activities of \$3.5 million for the same quarter of 2003. This year-over-year variance is due to fewer additions to property, plant and equipment and less proceeds from real estate sales in the first quarter of 2004 relative to the same period in 2003. Additions to property, plant and equipment in the first quarter 2004 were negligible at \$0.5 million, while first quarter 2003 capital expenditures of \$7.5 million included \$3.3 million to complete the North Island log sort and \$2.9 million towards the purchase of new dry kilns and other improvements at the Elk Falls lumbermill.

As at March 31, 2004, TimberWest's consolidated debt was \$248.0 million compared to total debt outstanding of \$255.0 million as at December 31, 2003. The Company's consolidated debt-to-total capitalization ratio as at March 31, 2004 was 22:78, compared to 23:77 as at December 31, 2003. Total debt facilities available to the Company as at March 31, 2004, were \$400.0 million, comprised of \$40.0 million available under the 364-day revolving facility due May 26, 2004, \$40.0 million available under the 364-day revolving facility due March 1, 2005, \$125.0 million available under the revolving credit facility maturing on June 30, 2006, and \$195.0 million of 7.0% debentures maturing on October 1, 2007.

In February 2004, the Company increased flexibility on all its bank credit facilities by obtaining an amendment to the Company's debt/EBITDA covenant. The amendment increased the test to 4.75:1 for the quarter ended March 31, 2004, from 4.25:1. For purposes of this covenant, the Company's debt/EBITDA was 3.44:1 for the quarter ended March 31, 2004. This debt/EBITDA covenant has reverted to 4.25:1 for future reporting periods.

### Accounting Policy Change

Effective January 1, 2004, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3110 – *Asset Retirement Obligations*. Section 3110

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establishes standards for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under this new standard, asset retirement obligations must be recognized at their fair value in the period in which they are incurred if a reasonable estimate of the fair value can be made, with fair value of a liability determined with reference to the present value of estimated future cash flows. This standard changed the Company's accounting for silviculture liabilities accrued for future reforestation costs. This change in accounting policy has been applied retroactively, however, there has been no material effect on the Company's consolidated financial statements.

TimberWest's asset retirement obligations at March 31, 2004 of \$6.7 million relate to silviculture liabilities accrued for future reforestation costs. Revisions to this liability could occur due to changes in estimated costs, timing of expenditures or possible new regulations related to reforestation.

### **Future Accounting Standard Change**

In 2001, the CICA Accounting Standards Board ("AcSB") commenced a project to amend the requirements in CICA Handbook Section 3860 – *Financial Instruments - Disclosure and Presentation*, concerning the balance sheet presentation of financial instruments, or their components, as liabilities or equity. The project was undertaken to improve consistency with guidance issued by both the US Financial Accounting Standards Board and the International Accounting Standards Board. Standards issued by each of these agencies require obligations that may be settled at the issuer's discretion by the issuance of its own equity instruments be presented as liabilities and not as equity.

In June 2003, the AcSB issued an exposure draft of a proposed Handbook revision that would require obligations that may be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. In November 2003, the AcSB approved this revision to Section 3860. The revision is effective for all fiscal years beginning on or after November 1, 2004.

The revision to Section 3860 will have a considerable effect on the financial statement presentation of the Company's Stapled Units and the distributions paid thereon, despite the fact that the Company's financial condition and economic underpinnings remain unchanged. The calculation of distributable cash generated by the Company will not be affected by this revision.

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

Given that the number of shares required to retire the Subordinate Note component is not fixed, the revision to Section 3860 will require that the Company reclassify the Series A Subordinate Note component of the Stapled Unit from equity to liabilities. Had the revision to Section 3860 been implemented by the Company at the end of the first quarter of 2004, the reclassification of the Subordinate Note component of the Stapled Unit from equity to liabilities at March 31, 2004, would have been \$685.9 million.

Further, holders of the Company's Stapled Units are entitled to annual interest payments on the Subordinate Note component of approximately \$1.08 per Stapled Unit. For the same reason that the Subordinate Note component is currently classified as equity on the Company's financial statements, interest payments on Stapled Units are currently charged directly to retained earnings, on an after-tax basis, as a distribution similar to dividends on common shares. The revision to Section 3860 will require distributions on Stapled Units to be reported, on a pre-tax basis, as an interest expense on the statement of operations. This revision also requires the tax benefit provided by the distributions to be reported as a component of the income tax provision on the statement of operations. Distributions on Stapled Units for the first quarter of 2004 were \$20.6 million and the tax benefit recognized thereon was \$7.3 million. Had the revision to Section 3860 been implemented by the Company for at the end of the first quarter of 2004, a net charge to earnings of \$13.3 million would have been required for the three months ended March 31, 2004.

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## Pension Valuation

The triennial actuarial valuation of the Company's pension obligations was completed during the first quarter of 2004. The valuation identified a going-concern deficit of \$3.9 million and a solvency deficit of \$5.1 million for the defined benefit segment of the Company's pension benefit plans. Based on the results of the valuation, the Company is required to fund annual current service costs of approximately \$1.4 million, including \$1.1 million for required contributions under the defined contribution segment and \$0.3 million for required contributions under the defined benefit segment. In addition, the Company is required to make annual contributions of \$0.4 million to fund the going-concern deficit and \$0.8 million to fund the \$5.1 million solvency deficit in the defined benefit segment. Therefore, the incremental cash contribution related to pension expense that will be deducted from distributable cash for 2004 is estimated at \$2.6 million.

## Outlook

For the balance of the year, the Company is optimistic about pricing in log and lumber markets and expects its cost reduction initiatives to remain on track.

In Japan, economic reports indicate that housing starts are improving slightly and that log and lumber inventories are low. With the yen strengthening relative to the Canadian dollar, offsetting part of the ocean freight increases, pricing in this market should remain stable in the near term.

In the US, economic reports indicate that demand for housing is expected to remain strong through the balance of 2004. This demand coupled with lower lumber inventories has meant that lumber prices have strengthened recently. While log prices in this market have improved it is not expected that prices will increase further.

Strong domestic demand for logs is expected to continue in the near term reflecting improvements in the Japanese and US lumber markets. Strength is also appearing in the Company's emerging markets, particularly South Korea where the demand for hemlock has been strong.

On the cost side the Company expects to continue with improvements to its productivity through the balance of the year. At time of writing, the industry on the Coast is waiting for the binding arbitration award to be delivered by the Commissioner. This award could have a substantial effect on the viability and competitiveness of the Coastal industry.

All conditions for closing the sale of TFL 46 have been removed and the transaction is scheduled to close in early May 2004. Sale proceeds on this transaction are expected to exceed the carrying value of the assets being disposed of.

As noted in the letter to unitholders, management is continuing to monitor the effect of ocean freight rates, the volume of old growth hemlock and fir coming into the market as a result of stumpage reductions and the on-going softwood lumber dispute with the US. Of course, the weather is always a factor in our business and concerns about another hot, dry summer are emerging. Were we to have conditions similar to last summer, we would expect curtailments on our logging operations.

In summary, the Company continues to anticipate that it will generate sufficient distributable cash to fund its distributions in 2004, without relying on the proceeds of the sale of TFL 46 to do so.

*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, actions of competitors, interest rate and foreign currency fluctuations, regulatory and harvesting fee changes and other actions by governmental authorities, the ability to implement business strategies and pursue business opportunities, labour relations, weather conditions, forest fires and other natural phenomena and other risks and uncertainties described in TimberWest's public filings with securities regulatory authorities.*



# TIMBERWEST FOREST CORP.

## Notice

The accompanying unaudited interim consolidated financial statements of TimberWest Forest Corp. (the "Company") have not been reviewed by the Company's auditors.

# TIMBERWEST FOREST CORP.

## Consolidated Statements of Operations

(in millions of dollars)  
Unaudited

	Three months ended March 31, 2004	Three months ended March 31, 2003
Net sales	\$ 101.6	\$ 126.6
Operating costs and expenses:		
Cost of products sold	67.2	89.7
Depreciation, depletion and amortization	2.9	2.6
Selling, administrative and other	3.5	3.8
	73.6	96.1
Operating earnings	28.0	30.5
Interest expense	4.1	4.0
Amortization of deferred financing costs	0.3	0.4
Other income	(0.2)	(0.4)
	4.2	4.0
Earnings before income taxes	23.8	26.5
Income tax expense (note 3)	6.7	8.8
Net earnings	\$ 17.1	\$ 17.7
<i>Basic and diluted earnings (loss) per common share (note 4)</i>	<i>\$ 0.05</i>	<i>\$ 0.06</i>

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

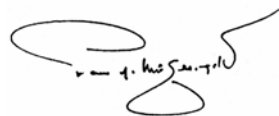
## Consolidated Balance Sheets

(in millions of dollars)

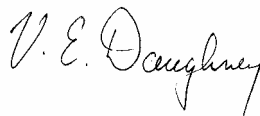
	As at March 31, 2004 <i>Unaudited</i>	As at December 31, 2003
<b>Assets</b>		
Current assets:		
Accounts receivable	\$ 25.6	\$ 15.4
Inventories	59.6	45.7
Prepaid expenses and other current assets	7.5	6.4
Future income taxes	2.6	2.6
	95.3	70.1
Property, plant and equipment, net (note 5)	1,353.4	1,356.5
Other assets	14.0	14.3
	\$ 1,462.7	\$ 1,440.9
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Revolving credit facilities (note 6)	\$ 53.0	\$ 60.0
Accounts payable and accrued liabilities	52.5	29.5
Distribution payable	20.6	20.5
	126.1	110.0
Debentures	195.0	195.0
Long-term silviculture liability	4.9	4.6
Non-pension post-retirement benefits	25.8	25.3
Future income taxes	229.7	230.5
	581.5	565.4
Unitholders' equity:		
Stapled Units, consisting of Series A Subordinate Notes, preferred shares and common shares	872.5	870.6
Contributed surplus	0.2	0.2
Retained earnings	8.5	4.7
	881.2	875.5
	\$ 1,462.7	\$ 1,440.9

See accompanying notes to unaudited interim consolidated financial statements.

On behalf of the Board of Directors:



Paul J. McElligott  
Director



V. Edward Daughney  
Director

# TIMBERWEST FOREST CORP.

## Consolidated Statements of Cash Flows

(in millions of dollars)  
Unaudited

Three months ended  
March 31, 2004

Three months ended  
March 31, 2003

### Cash provided by (used in):

#### Operating activities:

Earnings before income taxes	\$	23.8	\$	26.5
Cash income taxes (note 3)		(0.2)		(0.2)

	23.6	26.3
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#### Items not involving cash:

Depreciation, depletion and amortization	3.2	3.0
Gain on sale of property, plant and equipment	(0.5)	(1.0)
Other non-cash items	0.7	-

	27.0	28.3
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#### Changes in non-cash working capital:

Accounts receivable	(10.2)	(4.0)
Inventories	(13.9)	(8.7)
Prepaid expenses and other working capital	(1.1)	0.5
Accounts payable and accrued liabilities	23.0	6.3

	24.8	22.4
--	------	------

#### Financing activities:

Distributions paid to unitholders	(20.5)	(20.5)
Issuance of Stapled Units on exercise of options	1.9	0.4
Revolving credit facilities	(7.0)	106.7
Redemption of 6.5% debentures	-	(106.5)

	(25.6)	(19.9)
--	--------	--------

#### Investing activities:

Proceeds from sale of property, plant and equipment	1.4	3.1
Additions to property, plant and equipment	(0.5)	(7.5)
Other assets	(0.1)	0.9

	0.8	(3.5)
--	-----	-------

#### Increase (decrease) in cash

	-	(1.0)
--	---	-------

#### Cash, beginning of period

	-	1.0
--	---	-----

#### Cash, end of period

\$	-	\$	-
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#### Supplemental information:

Interest paid	\$	0.8	\$	4.1
Income taxes paid	\$	0.2	\$	0.2

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Consolidated Statements of Unitholders' Equity

(in millions of dollars)  
Unaudited

	Stapled Units		Contributed surplus	Retained earnings	Total unitholders' equity
	Number	Amount			
<b>For the three months ended March 31, 2003:</b>					
Balance, December 31, 2002	76,192,788	\$ 870.1	\$ 0.1	\$ 44.6	\$ 914.8
Issuance of Stapled Units on exercise of options	46,667	0.4	-	-	0.4
Net earnings	-	-	-	17.7	17.7
Interest on Series A Subordinate Notes	-	-	-	(20.5)	(20.5)
Income tax benefit thereon (note 3)	-	-	-	7.7	7.7
<b>Balance, March 31, 2003</b>	<b>76,239,455</b>	<b>\$ 870.5</b>	<b>\$ 0.1</b>	<b>\$ 49.5</b>	<b>\$ 920.1</b>
<b>For the three months ended March 31, 2004:</b>					
Balance, December 31, 2003	76,246,122	\$ 870.6	\$ 0.2	\$ 4.7	\$ 875.5
Issuance of Stapled Units on exercise of options	<b>150,200</b>	<b>1.9</b>	-	-	<b>1.9</b>
Net earnings	-	-	-	17.1	17.1
Interest on Series A Subordinate Notes	-	-	-	(20.6)	(20.6)
Income tax benefit thereon (note 3)	-	-	-	7.3	7.3
<b>Balance, March 31, 2004</b>	<b>76,396,322</b>	<b>\$ 872.5</b>	<b>\$ 0.2</b>	<b>\$ 8.5</b>	<b>\$ 881.2</b>

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three months ended March 31, 2004 and 2003

Financial figures presented in the tables that follow are in millions of dollars, except per common share amounts.

### 1. Significant Accounting Policies

These unaudited interim consolidated financial statements include the accounts of TimberWest Forest Corp. and its subsidiaries. Not all disclosures required by Canadian generally accepted accounting principles for annual financial statements are presented, and accordingly, these interim consolidated financial statements should be read in conjunction with the Company's most recent annual consolidated financial statements. These interim consolidated financial statements follow the same accounting policies and methods of application used in the Company's audited annual consolidated financial statements of December 31, 2003, except for a change in accounting for asset retirement obligations as described in note 2.

### 2. Accounting Policy Change

Effective January 1, 2004, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants' (CICA) Handbook Section 3110 – *Asset Retirement Obligations*. Section 3110 establishes standards for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under this new standard, asset retirement obligations must be recognized at their fair value in the period in which they are incurred if a reasonable estimate of the fair value can be made, with fair value of a liability determined with reference to the present value of estimated future cash flows. This standard changed the Company's accounting for silviculture liabilities accrued for future reforestation costs. This change in accounting policy has been applied retroactively, however, there has been no material effect on the Company's consolidated financial statements.

The Company may have additional asset retirement obligations, however, the recommendations of this new standard have not been applied to assets with indeterminate useful lives as the associated asset retirement obligations are not reasonably estimable and therefore the fair value of the liabilities cannot be established.

### 3. Income Taxes

	Three months ended March 31	
	2004	2003
Current income tax expense		
Large corporation tax	\$ 0.2	\$ 0.2
Income tax benefit on interest on Series A Subordinate Notes charged directly to distributions	7.3	7.7
	7.5	7.9
Future income tax expense (recovery)	(0.8)	0.9
	\$ 6.7	\$ 8.8

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three months ended March 31, 2004 and 2003

### 4. Earnings per Share

	Three months ended March 31	
	2004	2003
Net earnings	\$ 17.1	\$ 17.7
Less: Distributions on Series A Subordinate Notes	(20.6)	(20.5)
Tax benefit thereon	7.3	7.7
	(13.3)	(12.8)
Earnings attributable to common shares	\$ 3.8	\$ 4.9
Basic weighted average number of common shares	76,308,086	76,203,079
Incremental common shares from potential exercise of options	106,660	89,031
Diluted weighted average number of common shares	76,414,746	76,292,110
Basic and diluted earnings per common share	\$ 0.05	\$ 0.06

The Company may elect to pay the interest on, and the principal amount of, Series A Subordinate Notes in common or preferred shares of the Company.

### 5. Property, Plant and Equipment

Property, plant and equipment at March 31, 2004, include \$1,218.4 million carrying value for private timberlands. This amount includes a valuation increase adjustment of \$390.8 million recorded in the year ended December 31, 2000, resulting from the adoption of Section 3465 – *Income Taxes* of the CICA Handbook, which was mandatory for fiscal years ending on or after January 1, 2000.

### 6. Revolving Credit Facilities

On March 2, 2004, the Company completed and received a renewal of short-term financing from a Canadian bank. The renewed financing consists of an unsecured demand bank guarantee facility in the amount of \$16.0 million and an unsecured 364-day committed revolving facility in the amount of \$40.0 million that is due on March 1, 2005. Under the 364-day facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate based loans, Canadian dollar bankers' acceptances and letters of credit or guarantee.

As at March 31, 2004, the Company had borrowings of \$53.0 million on the Company's two \$40.0 million unsecured 364-day revolving facilities.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three months ended March 31, 2004 and 2003

### 7. Stock-based Compensation Plans

Under the Company's Stapled Unit Option Plan, the Company may grant options for the purchase of Stapled Units to directors, officers or employees who are in active service or employment of the Company or of any of its subsidiaries. In the first quarter of 2004, 313,220 Stapled Unit options were granted (2003 – 267,047) at an average exercise price of \$12.21 (2003 – \$11.90) under the Stapled Unit Option Plan. The Company has applied the fair value method of accounting for Stapled Unit options from January 1, 2003. A charge of \$33,000 has been recognized in net earnings for the three month period ended March 31, 2004, representing the fair value of options granted in 2003 and 2004, amortized over their three-year vesting period (2003 – \$16,000), with a corresponding credit to contributed surplus. Had the Company used the fair value method to account for Stapled Unit options granted during 2002, there would have been no adjustment to net earnings and earning per common share reported for the three months ended March 31, 2004 and 2003 as the stock-based compensation cost related to these options was nominal.

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

	2004	2003
Risk-free interest rate	4.5%	4.3%
Expected life (years)	5.0	5.0
Expected volatility	20.6%	25.3%
Dividend yield	8.6%	9.1%
Number of options granted	313,220	267,047
Fair value of options granted (dollars)	\$0.86	\$1.07

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. The Company applies the principles of the fair value based method of accounting for stock-based compensation to awards granted under this plan. Awards are accrued on a basis equal to actual distributions paid on the Company's issued and outstanding Stapled Units and are charged to earnings as the underlying Stapled Unit options vest. For the three months ended March 31, 2004, \$0.3 million has been accrued for awards granted under this plan (2003 – \$0.2 million) and \$0.3 million has been amortized against earnings for the quarter (2003 – \$0.3 million).

In addition to the options granted during the quarter ended March 31, 2004, 150,200 Stapled Unit options with exercise prices ranging from \$8.91 to \$13.03 were exercised (2003 – 46,667 Stapled Unit options with an exercise price of \$8.91 were exercised and 5,267 Stapled Unit options with an exercise price of \$13.03 were cancelled).

### 8. Sale of Tree Farm Licence 46 (TFL 46)

On January 21, 2004, the Company signed a definitive agreement for the sale of its southern Vancouver Island public land operations, referred to as TFL 46. All conditions for closing the sale of TFL 46 have been removed and the sale is scheduled to close in early May 2004. Sale proceeds on this transaction are expected to exceed the carrying value of the assets being disposed of.

# TIMBERWEST FOREST CORP.

## Supplemental Information

Unaudited

Three months ended March 31

2004

2003

### Sales by Product

(in millions of dollars)

Logs	\$	79.3	\$	103.8
Lumber		17.6		16.6
Wood chips and other		3.8		3.6
Real estate		0.9		2.6

	\$	101.6	\$	126.6
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### Sales Volume

Logs (thousand m <sup>3</sup> )	753.0	919.4
Lumber (million fbm)	32.0	31.1

### Production Volume

Logs (thousand m <sup>3</sup> )	919.7	893.0
Lumber (million fbm)	40.2	35.5

### Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)\*

(in millions of dollars)

Net earnings	\$	17.1	\$	17.7
Add:				
Interest expense		4.1		4.0
Income tax expense		6.7		8.8
Depreciation, depletion and amortization		2.9		2.6
Amortization of deferred financing costs		0.3		0.4

	\$	31.1	\$	33.5
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\* EBITDA does not have a standardized meaning prescribed by Canadian generally accepted accounting principles and may not be comparable to similar measures presented by other companies.

# TIMBERWEST FOREST CORP.

## About TimberWest

TimberWest Forest Corp. is uniquely positioned as the largest owner of private forest lands in western Canada. The Company's 334,000 hectares, providing a sustainable annual harvest of 2.3 million m<sup>3</sup> of logs, which can vary in the range of 2.1 million m<sup>3</sup> to 2.5 million m<sup>3</sup> under our SFI® certification, are located on Vancouver Island and predominantly support the growth of Douglas fir forests, a premium species used for structural purposes. Third party auditors have certified that the management of the Company's private forest land conforms to the objectives and performance measures of the American Forest and Paper Association's Sustainable Forestry Initiative (SFI®). TimberWest also owns annual Crown harvest rights of 1.3 million m<sup>3</sup> of logs and a lumbermill. In addition, approximately 6,000 hectares of the Company's private forest lands have been identified as having greater value as real estate properties and are progressively being made available for higher uses.

## TimberWest Forest Corp.

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Stapled Units of TimberWest Forest Corp. are traded on the Toronto Stock Exchange under the symbol: TWF.UN

Visit us at our web site: [www.timberwest.com](http://www.timberwest.com)

