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## **THIRD QUARTER INTERIM REPORT**

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**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003**

**TimberWest Forest Corp.**

## TIMBERWEST FOREST CORP.

### To Our Unitholders,

While I am pleased to report that TimberWest did not lose any of its tree farm estate to the widely publicized forest fires which occurred in British Columbia over the summer months, the third quarter of this year was a very difficult one for the Company. As in the preceding quarter, we struggled with three issues: all major markets TimberWest sells into remained over supplied for both logs and lumber; the Canadian dollar remained strong relative to its US counterpart; and the Canada/US softwood lumber dispute continued unresolved. Added to the above, the Company experienced the driest operating season in more than 60 years of record-keeping, resulting in extended logging curtailments due to risk of fire in the quarter.

Lumber mills operating on the coast of BC, where TimberWest sells the majority of its log volume, experienced extended periods of downtime again this quarter. Capacity utilization for the coastal sawmilling industry was an estimated 66% during the quarter. Weak domestic demand for logs combined with the extended fire season resulted in lower than normal levels of log production and log sales.

All of the foregoing resulted in third quarter sales revenues being 23% lower than the equivalent prior year period. Log sales volumes declined 5% quarter-over-quarter while average sales realizations declined 18% to our lowest level ever. However, thanks to the strong start to the year in the first quarter, year to date revenues in 2003 are only 1% below the equivalent prior year period, with log sales realizations down 6% year to date.

On closer review, the most significant impact on our sales revenues for the quarter compared to this time last year comes not from the broader market factors such as currency and the softwood file, but from our inventory mix. In fact, about 60% of the reduction in log sales realizations comes from having a lower value inventory than the third quarter of 2002, which happened to be our best third quarter ever for log sales revenue. Having come into the quarter with a poorer log inventory mix, the situation was exacerbated by low production. In particular, we had limited access to helicopters this summer as most were assisting in the fire fighting effort throughout the province. Our helicopter logging program gives us access to some of our highest value fibre. As a result we were left with a higher component of pulp logs in the mix, less Japan export quality fibre, and considerably less higher value cedar and fir.

As well, the cost side of our business was a challenge this quarter. While our public land logging operations were virtually fully curtailed during the quarter due to weak market conditions, extreme fire hazard conditions negatively impacted all of the Company's private timberland operations. Each operation had between nine and 24 days of full shutdown plus many restricted activity days during the 62 scheduled operating days.

Obviously this affected our Operations Excellence strategy and cost reduction progress. All operations continued to work hard on Operations Excellence initiatives and for the quarter the private land operations were able to make good progress against their targets despite the tough operating conditions. However, our public land logging operations were not able to achieve their targets and in fact, having to absorb all of their fixed costs during the quarter offset the Operations Excellence gains made in other parts of the organization. On a year to date basis, our logging production costs are better than this time last year. Some of the benefits have accrued by way of lower stumpage and the implementation of lower cost harvesting systems, but more importantly they have accrued as a result of our cost reduction initiatives. The cost reductions we have achieved helped claw back some of the reduction in our margin as a result of the top line deterioration and the shutdowns we sustained.

In order to start making up for lost production time and to lower costs, operational changes were implemented during September when rain finally arrived on Vancouver Island. Where cost effective, log sorting yards have been operating 12 hours per day, seven days a week. Logging contractors have been working seven days a week and have hauled logs every day that sorting facilities were open. These changes will continue on private lands until fire-related production losses are reversed. We expect to reach our 2003 target level of production on our private lands by year end if there are no work stoppages or additional weather related shutdowns. At this volume level, the Company also expects to meet its private land cost reduction target of \$4.50 per m<sup>3</sup> for the year. We do not expect to make up for our volume shortfall nor our cost reduction targets on public lands.

The Elk Falls lumbermill had a difficult quarter as well, with lumber pricing down 22% over third quarter 2002. One of Elk's main objectives for 2003 was to have the mill up and running on three shifts by July 1, 2003. The mill was producing on a three-shift basis earlier than planned. Unfortunately, adverse market conditions meant Elk had to curtail operations beginning in July and remained down for about half of the third quarter.

Positive news in the quarter included solid progress towards our safety goals. Timberland operations continued the trend of improvement in safety performance with a year to date MIR rating of 4.39. This is a substantial improvement over the previous year's MIR of 5.39. Elk's year to date MIR rating is 2.10, versus a plan of 4.0. I congratulate employees for staying focused on working safely during such challenging times.

The result of all of this was that the Company generated distributable cash for the quarter of \$12.0 million, or \$0.16 per unit, compared to \$34.1 million, or \$0.45 per unit, for the third quarter of 2002. On a year to date basis, distributable cash is \$42.4 million compared to \$65.9 million this time last year and that is after running an extra \$13.0 million in higher than normal

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CAPEX spending through this year's number. TimberWest has paid out \$61.6 million to its unitholders to the end of the third quarter, so you can see that we have borrowed for the unusually high level of capital expenditures we have made this year.

Assuming no work stoppages in the fourth quarter, the Company still expects to generate sufficient distributable cash to cover its distributions for the year after normalizing for capital expenditure levels. As such, I am pleased to announce TimberWest's next quarterly distribution of \$0.269 per Stapled Unit, payable on January 15, 2004, to unitholders of record on January 1, 2004.

## Key Initiatives

TimberWest management initiated an auction process for the sale of TFL 46 and associated forest licenses in September. We believe it is the right time to offer this asset for sale given public tenure and other forest policy reforms underway in British Columbia. Moreover, TFL 46 is not part of our core business.

We are always looking at our portfolio of assets to focus our efforts on areas that drive maximum return for our unitholders. We believe we may have an opportunity to realize better value from TFL 46 today by selling it. Our core business is our private timberlands. For other companies, owning and operating a TFL is a core business strategy and thus they may place a higher value on the TFL. The Company is hopeful that a purchase and sale agreement for TFL 46 can be concluded by calendar year end.

Labour negotiations between Forest Industrial Relations ("FIR"), which bargains on behalf of TimberWest, and the IWA resumed on October 2, 2003, with the assistance of a facilitator. After a number of proposals were exchanged, negotiations broke down on October 9, 2003, when FIR rejected the IWA's final offer. The IWA subsequently applied to the British Columbia Labour Relations Board to have all 61 employers represented by FIR vote on their final offer. FIR's board of directors had unanimously agreed to recommend that FIR member companies reject the IWA proposal.

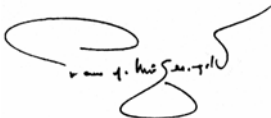
FIR has also challenged the legality of the Union offer with the Labour Relations Board. While the matter is being sorted out at the Labour Board, the IWA is not able to engage in strike activities.

The IWA's offer is for a six year collective agreement, 9% wage increases over that period of time, increased pension contributions, profit sharing, and severance improvements. There are no substantive changes being proposed which would benefit TimberWest's operations.

Finally, in order to raise awareness of the structural problems facing the public land logging and sawmilling industry on the coast of BC and the need to regain competitiveness, TimberWest has worked with International Forest Products and Weyerhaeuser to co-author a report describing a vision of what a rejuvenated BC Coastal forest industry could look like in the next 10 years — if the right moves are made now to rebuild the sector. The report — *Embracing a New Vision: Rebuilding BC's Coastal Forest Industry* — calls on all industry players to come together to collectively address the problems that are devastating one of the province's prime economic generators. In the report and subsequent media interviews, my colleagues and I made it clear that rebuilding the industry requires not only capital reinvestment but also the implementation of government policy reform and modernization of labour agreements. We remain hopeful other industry stakeholders will play their role in making this vision a reality.

I thank you for your continued support and interest in our Company — particularly in these challenging times.

On behalf of the Board of Directors



Paul J. McElligott  
President and Chief Executive Officer

Vancouver, British Columbia  
October 21, 2003

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## Management's Discussion and Analysis

For the three and nine months ended September 30, 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 third quarter of 2003. This discussion and analysis provides an overview of significant developments that have affected TimberWest's performance during the third quarter and year to date of 2003 relative to the third quarter and year to date of 2002, and that have affected the Company's financial position as at September 30, 2003, relative to December 31, 2002. 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 2002 Annual Report.

### Distributable Cash

In compliance with recent changes to CICA Handbook Section 1540 – *Cash Flow Statements*, TimberWest will no longer be including separate statements of distributable cash in its financial statements. Information previously presented in the statements of distributable cash will now be included in the Management's Discussion and Analysis.

	Three months ended September 30		Nine months ended September 30	
	2003	2002	2003	2002
<i>(in millions of dollars, except per Stapled Unit amounts)</i>				
Net earnings	\$ 6.3	\$ 12.9	\$ 25.5	\$ 22.4
Income tax benefit related to distributions	3.3	9.1	15.9	17.5
Earnings available for distribution	9.6	22.0	41.4	39.9
Future income tax expense (recovery)	(1.4)	-	(0.5)	2.3
Earnings available for distribution before provision for future income tax expense (recovery)	8.2	22.0	40.9	42.2
Add (deduct):				
Depreciation, depletion and amortization	2.5	3.1	8.4	11.3
Proceeds from sale of capital assets	3.0	14.5	6.9	17.2
Gain on sale of capital assets	(1.5)	(3.0)	(2.8)	(3.6)
Capital expenditures	(2.0)	(4.3)	(17.0)	(6.0)
Other non-cash items	1.8	1.8	6.0	4.8
	3.8	12.1	1.5	23.7
Distributable cash	\$ 12.0	\$ 34.1	\$ 42.4	\$ 65.9
<i>Basic and diluted distributable cash per weighted average Stapled Unit</i>	\$ 0.16	\$ 0.45	\$ 0.56	\$ 0.89
<i>Cash distributions paid per Stapled Unit</i>	\$ 0.27	\$ 0.27	\$ 0.81	\$ 0.81

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

Distributable cash and earnings available for distribution are measures that do not have a standardized meaning prescribed by Canadian generally accepted accounting principles ("GAAP") and may not be comparable to similar measures presented by other companies. 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.

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Quarterly comparison of distributable cash generated:

	2003	2002	2001	2000	1999	1998
<b>Distributable Cash</b> (in millions of dollars)						
First	\$ 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		24.2	16.8	18.5	19.7	19.6
	\$ 42.4	\$ 90.1	\$ 83.5	\$ 89.2	\$ 83.3	\$ 68.3
<b>Distributable Cash per Stapled Unit</b> (in dollars)						
First	\$ 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	0.16	0.45	0.22	0.22	0.20	0.17
Fourth		0.32	0.26	0.29	0.28	0.28
	\$ 0.56	\$ 1.21	\$ 1.29	\$ 1.34	\$ 1.20	\$ 0.98

## Quarterly Financial Highlights

TimberWest generated distributable cash of \$12.0 million or basic and diluted distributable cash of \$0.16 per weighted average Stapled Unit for the quarter ended September 30, 2003, compared to distributable cash of \$34.1 million, or basic and diluted distributable cash of \$0.45 per weighted average Stapled Unit for the same period in 2002. The decrease from 2002 can be attributed to greater than normal proceeds from sale of capital assets of \$14.5 million in the third quarter of 2002, including proceeds of \$11.5 million from the sale of the Company's Earle Creek property, compared to more typical proceeds from sale of capital assets in the third quarter of 2003 of \$3.0 million. 2002 distributable cash also reflects a one-time loss of \$5.0 million on a bond lock transaction entered into in anticipation of a refinancing of debentures outstanding at that time. Earnings available for distribution for the quarter, before provision for future income taxes, were \$8.2 million or \$0.11 per basic and diluted weighted average Stapled Unit compared to \$22.0 million or \$0.29 per basic and diluted weighted average Stapled Unit for the same quarter in 2002. Net sales for the third quarter of 2003 were \$100.3 million compared to net sales of \$130.4 million reported for the third quarter of 2002. Operating earnings were \$12.0 million for the third quarter of 2003 compared to \$30.7 million for the same quarter in 2002. Earnings before interest, taxes, depreciation and amortization ("EBITDA")<sup>1</sup> for the quarter ended September 30, 2003, were \$14.8 million or \$0.19 per basic and diluted weighted average Stapled Unit compared to \$33.7 million or \$0.44 per basic and diluted weighted average Stapled Unit for the same period in 2002.

On September 26, 2003, the Company completed a public offering of \$65.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007. The debentures were sold at 101.28% of their principal amount, plus accrued interest of \$2.2 million from April 1, 2003, with net proceeds to the Company of \$67.3 million. The Company used these proceeds to reduce indebtedness under its revolving credit facilities.

## Year to Date Financial Highlights

TimberWest generated distributable cash of \$42.4 million or basic and diluted distributable cash of \$0.56 per weighted average Stapled Unit for the nine months ended September 30, 2003, compared to distributable cash of \$65.9 million, or basic and diluted distributable cash of \$0.89 per weighted average Stapled Unit for the same period in 2002. This decrease can be attributed to lower operating earnings and higher capital expenditures in 2003 compared to 2002, with 2003 including \$17.0 million of capital expenditures compared to capital expenditures of \$6.0 million in 2002. 2002 distributable cash also includes higher than typical proceeds from sale of capital assets of \$17.2 million compared to \$6.9 million in 2003, and also reflects a one-time, pre-tax restructuring charge of \$9.8 million recorded during the second quarter of 2002 and a one-time, pre-tax loss on a bond lock transaction of \$5.0 million recorded during the third quarter of 2002. Earnings available for distribution for the first nine months of 2003, before provision for future income taxes, were \$40.9 million, or \$0.54 per basic and diluted weighted average Stapled Unit compared to \$42.2 million, or \$0.57 per basic and diluted weighted average Stapled Unit for the same period in 2002. Net sales for the first nine months of 2003 were \$336.2 million compared to net sales of \$340.0 million reported for the same period of 2002. Operating earnings were \$52.9 million for the first three quarters of 2003 compared to \$70.9 million for the same period in 2002. EBITDA for the nine months ended September 30,

<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. 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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2003, were \$61.6 million or \$0.81 per basic and diluted weighted average Stapled Unit compared to \$70.0 million, or \$0.94 per basic and diluted weighted average Stapled Unit for the same period in 2002.

As noted above, during the third quarter of 2003, the Company completed a public offering of \$65.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007. Net proceeds to the Company of \$67.3 million were used to reduce indebtedness under existing revolving credit facilities.

During the second quarter of 2003, the Company completed short-term financing from a Canadian bank in the amount of \$40.0 million in the form of an unsecured 364-day revolving facility due May 26, 2004, and completed a two-year extension to its \$125.0 million unsecured revolving facility now due June 30, 2006.

During the first quarter of 2003, the Company completed and received additional 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, 2004.

In addition, during the first quarter of 2003, the Company retired \$106.5 million aggregate principal amount of its 6.5% debentures when they matured on March 3, 2003.

## Cash Distribution

On October 21, 2003, TimberWest announced a distribution of \$0.269 per Stapled Unit, payable January 15, 2004, to unitholders of record on January 1, 2004. Since TimberWest's inception in July 1997, including the distribution paid on October 15, 2003, the Company has distributed \$463.8 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 September 30, 2003, were \$76.2 million, down 23% from log sales of \$99.0 million for the quarter ended September 30, 2002. This decrease reflects lower log sales volumes and lower log sales realizations in the third quarter of 2003 relative to the third quarter in 2002. Market-related shutdowns continued at most mills on the BC coast through the third quarter of 2003, reflecting continued weakness in global lumber markets. The weakness in domestic demand was evidenced by a 7% decrease in domestic log sales volumes, to 470.3 thousand m<sup>3</sup>. Domestic log sales realizations for the quarter were down 15%, to \$84 per m<sup>3</sup>, compared to the third quarter of 2002. Most of the reduction in domestic log sales realizations can be attributed to a weak mix of log inventory going into the quarter and low production during the quarter. Third quarter export sales volumes were down marginally year-over-year, coming in at 316.4 thousand m<sup>3</sup> compared to 322.5 thousand m<sup>3</sup> in 2002, with volumes into US markets increasing by 27% to 168.3 thousand m<sup>3</sup>, representing 53% of total export sales, and volumes into Asian markets falling by 22% from the comparative quarter in 2002 to 148.1 thousand m<sup>3</sup>. Year to date, export log sales realizations were down 23%, to \$116 per m<sup>3</sup>, with sales realizations into US and Asian markets down 20% and 18%, respectively. A weak log inventory mix through the quarter had a greater effect on export log sales realizations than did broader market factors such as currency rates and the Canada/US softwood lumber dispute. Access to helicopters during the quarter was limited due to their involvement in firefighting activities, further exacerbating this effect. Reductions in the helicopter logging program during the quarter resulted in a reduction in the harvest and sale of some of the Company's highest value fibre during this period.

The operating margin from timberland operations for the third quarter of 2003 averaged 23% of log sales compared to 31% for the third quarter of 2002, reflecting the impact of lower log sales volumes and realizations described above. The impact of lower realizations was partially mitigated by the continued focus on cost reduction and a decrease in harvests from higher-cost public lands, and due to use of lower cost harvest systems, including less helicopter logging in the current quarter relative to the comparative period in 2002. These factors resulted in a decrease in production costs for the third quarter of 2003, dropping to \$73 per m<sup>3</sup> from \$82 per m<sup>3</sup> for the third quarter of 2002. Logging production volumes for the quarter were down 22% over the comparative period in 2002, reflecting operational curtailments taken in July to address weak market conditions, as well as weather-related curtailments taken in August to minimize the risk of forest fires as Vancouver Island experienced its driest summer in 62 years.

Log sales for the nine months ended September 30, 2003, were \$270.3 million, down 2% from log sales of \$274.8 million for the comparative period in 2002. This decrease reflects the net effect of a 6% decrease in average log sales realizations and a 5% increase in the volume of logs sold relative to the comparative period in 2002. Overall log sales realizations for the first nine months of 2003 averaged \$103 per m<sup>3</sup> compared to \$110 per m<sup>3</sup> for the comparative period in 2002, with realizations on domestic sales dropping 4% to \$89 per m<sup>3</sup> and realizations on export sales dropping 6% to \$124 per m<sup>3</sup> compared to the prior year period. Year to date log sales reflect a very strong first quarter where log sales volumes were 41% greater than the comparative quarter in 2002. Domestic market sales for the first quarter of 2003 were more than double those for the comparative quarter in 2002. The favourable results of the first quarter of 2003 have been offset by weaker sales levels in the second and third quarter reflecting the effects of global weakness in lumber markets, a strengthening Canadian dollar relative to its US counterpart and reduced use of higher cost harvest systems compared to the prior year period. 2003 year

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to date domestic log sales volumes of 1,548.2 thousand m<sup>3</sup> are up 11.3% compared to 2002, while export sales volumes are down 4% over the comparative period in 2002, to 1,114.8 thousand m<sup>3</sup>. Year to date volumes sold to US and Asian markets decreased 7% and 1%, respectively. US and Asian markets each accounted for approximately one-half of 2003 year to date export sales volumes, consistent with the same period in 2002.

The timberland operations' operating margin for the first nine months of 2003 was 26%, down 3% from 29% of log sales for the first nine months of 2002, reflecting the impact of lower log sales realizations described above. As in the third quarter of 2003, on a year to date basis the impact of lower log sales realizations has been partially mitigated by cost reductions, a decrease in harvests from higher-cost public lands and the use of lower cost harvest systems, resulting in a decrease in production costs to \$73 per m<sup>3</sup>, down from \$76 per m<sup>3</sup> for the comparative period in 2002. Logging production volumes for the first nine months of 2003 were down 7% over the comparative period in 2002, reflecting the net effect of increased harvests in the first quarter of 2003 owing to favourable weather conditions and reduced harvests in the second and third quarters of 2003 due to market and weather-related curtailments.

Lumber sales for the quarter ended September 30, 2003, of \$14.8 million were slightly ahead of sales of \$14.1 million for the quarter ended September 30, 2002. This reflects the net effect of a 34% increase in the volume of lumber sold mostly out of inventory, rising to 36.5 million board feet for the third quarter of 2003 from 27.2 million board feet for the third quarter of 2002, and a 22% decline in average lumber sales realizations, falling to \$406 per mfbm from \$520 per mfbm for the comparative period in 2002, reflecting the strengthening of the Canadian dollar over the comparative period. Weakness in the Japanese market continued through the third quarter of 2003 and resulted in market-related curtailments at the mill during this period due to a weak order file, resulting in a 47% drop in production compared to the same period in 2002.

Lumber sales for the nine months ended September 30, 2003, of \$46.1 million were 16% greater than sales of \$39.9 million for the comparative period in 2002. This improvement reflects a 22% increase in the volume of lumber sold, rising to 101.1 million board feet for the first nine months of 2003 from 82.7 million board feet for the same period in 2002, offset in part by a 5% decrease in average lumber sales realizations, falling to \$456 per mfbm from \$482 per mfbm for the comparative period in 2002. Adverse market and economic conditions continued through the third quarter and have unfavorably impacted operating results at the lumbermill for the first nine months of 2003. On a year to date basis, production levels for 2003 were comparable to those in the prior year.

Wood chip sales for the third quarter of 2003 of \$1.1 million were down 42% from the comparative period in 2002, reflecting the impact of mill curtailments during the quarter. Chip sales for the first nine months of 2003 of \$6.2 million were 13% greater than the same period in 2002 as a result of increased chip volumes available for sale due to increased production at the Company's lumbermill facility. Market-related curtailments throughout the industry during the third quarter of 2003 saw wood chip sales realizations for the quarter and the first nine months of the year return to levels comparable to those for the same periods in 2002.

Real estate sales of \$3.4 million for the third quarter of 2003 were considered typical and, combined with activity reported in the first half of the year, have resulted in year to date real estate sales of \$6.6 million. This compares to sales of \$14.0 million and \$16.4 million for the third quarter and year to date 2002, respectively. Prior year results reflect the sale of TimberWest's Earle Creek property, a significant property located on the Sunshine Coast of BC, in the third quarter of 2002 for proceeds of \$11.5 million.

## Financial Position

Current assets decreased \$11.7 million to \$90.6 million at September 30, 2003, from \$102.3 million as at December 31, 2002. This decrease primarily reflects a \$12.1 million decrease in inventories during the first nine months of 2003, with log inventory decreasing \$6.1 million to \$51.0 million and lumber inventory decreasing \$6.0 million to \$2.5 million. These reductions are indicative of limited production during the third quarter of 2003 at both timberland and lumbermill operations due to market and weather-related shutdowns and have resulted in lower log and lumber inventory volumes at the end of the third quarter.

Capital assets of \$1,359.9 million as at September 30, 2003, were \$4.3 million greater than at December 31, 2002, reflecting \$17.0 million in capital expenditures during the first nine months of 2003, partially offset by the year to date provision for depreciation, depletion and amortization of \$7.3 million and the sale of capital assets for proceeds of \$6.9 million. Major capital expenditures made during the first nine months of 2003 include \$9.2 million towards improvement projects at the Elk Falls lumbermill, including the purchase of three new lumber drying kilns and the replacement of the trimmer optimizer, \$3.3 million to complete the North Island log sort, and \$2.1 million on road building activities for timberland operations.

Current liabilities at the end of the third quarter of 2003 were \$103.9 million, down \$69.1 million from \$173.0 million as at December 31, 2002. This decrease can be primarily attributed to the net effect of the retirement of \$106.5 million aggregate principal amount of 6.5% debentures upon their maturation in the first quarter of 2003, offset in part by \$42.0 million drawn on available short-term revolving credit facilities. Accounts payable and accrued liabilities decreased \$4.6 million during the first nine months of 2003, to \$41.4 million at September 30, 2003. The distribution payable at the end of the third quarter of 2003 of \$20.5 million is consistent with the distribution payable at December 31, 2002, and reflects a consistent per unit distribution and no significant change in the number of Stapled Units outstanding during the first nine months of 2003.

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Long-term liabilities as at September 30, 2003, included \$15.1 million drawn on the Company's \$125.0 million unsecured revolving credit facility and \$195.0 million aggregate principal amount of 7.0% unsecured senior debentures. During the third quarter of 2003, the Company completed a public offering of \$65.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007. The debentures were sold at 101.28% of their principal amount, plus accrued interest of \$2.2 million from April 1, 2003, with net proceeds to the Company of \$67.3 million used to reduce indebtedness under the Company's revolving credit facilities. Long-term liabilities at the end of the third quarter of 2003 also included a silviculture liability of \$4.4 million, a \$24.5 million liability relating to non-pension post retirement benefits and a future income tax liability of \$230.6 million. These liabilities have not changed materially from balances reported at December 31, 2002.

During the quarter ended September 30, 2003, no Stapled Unit options were exercised, no options were granted and 1,366 options were cancelled. During the nine months ended September 30, 2003, options to purchase 53,334 Stapled Units were exercised for proceeds of \$0.5 million, 267,047 options were granted and 9,367 options were cancelled.

### Cash Flow and Liquidity

Net cash generated from operations before changes in non-cash working capital for the three months ended September 30, 2003, was \$9.2 million or \$0.12 per weighted average Stapled Unit compared to \$22.7 million or \$0.30 per weighted average Stapled Unit for the corresponding quarter in 2002. Year to date, net cash generated from operations before changes in non-cash working capital was \$46.8 million or \$0.61 per weighted average Stapled Unit compared to \$52.4 million or \$0.71 per weighted average Stapled Unit for the comparative period in 2002. During the third quarter of 2003, non-cash working capital decreased by \$20.2 million compared to an \$8.0 million increase reported for the same period in 2002. On a year to date basis non-cash working capital decreased by \$5.2 million compared to an \$8.8 million decrease reported for the same period in 2002. Current year decreases reflect the net effect of lower inventory levels offset in part by higher accounts receivable and lower accounts payable and accrued liabilities balances at the end of the third quarter of 2003 compared to December 31, 2002.

Net cash used in financing activities during the third quarter of 2003 was \$31.2 million compared to \$25.7 million used in financing activities for the comparative period of 2002. Financing cash flows for the three months ended September 30, 2003, include the payment of the third quarter distribution to unitholders of \$20.6 million compared to \$20.5 million in 2002, and reflect receipt of proceeds from the public offering of \$65.0 million aggregate principal amount of 7.0% unsecured senior debentures closed during the quarter and the application of these proceeds to reduce borrowings on revolving credit facilities. Net cash used for financing activities during the first nine months of 2003 was \$45.4 million, a decrease of \$27.8 million over the same year to date period in 2002. Year to date 2003, the Company made distributions of \$61.6 million to unitholders compared to distributions of \$58.3 million in the first nine months of 2002. During the first nine months of 2003, the Company issued 53,334 Stapled Units for net proceeds of \$0.5 million on the exercise of Stapled Unit options, compared to \$3.1 million received on the exercise of 302,515 options in the comparative period of 2002. In the first nine months of 2003, the Company had net drawings of \$57.1 million on its revolving credit facilities, reflecting drawings of \$106.5 million in the first quarter to retire the Company's 6.5% debentures, and the use of proceeds of \$65.8 million on the closing of the public offering of 7% unsecured senior debentures in the third quarter to pay down revolving credit facilities. In the first nine months of 2002, excess cash of \$17.1 million generated from operations was used to repay amounts owing on credit facilities. Further, a public equity offering was completed during the first quarter of 2002, providing net proceeds of \$136.1 million, which were used to settle amounts outstanding on the Company's previously outstanding non-revolving credit facility.

Net cash provided by investing activities during the third quarter of 2003 was \$1.8 million compared to net cash provided by investing activities of \$11.0 million for the same quarter of 2002. This year-over-year variance is primarily due to greater proceeds from real estate sales in the third quarter of 2002 relative to the same period in 2003, most notable being the receipt of proceeds of \$11.5 million on the sale of the Company's Earle Creek property in the third quarter of 2002. For the nine months ended September 30, 2003, net cash used in investing activities was \$7.6 million compared to net cash provided by investing activities of \$12.0 million for the comparative period in 2002. The variance from 2002 can be primarily attributed to an additional \$11.0 million in capital expenditures in 2003, including improvements at the Elk Falls lumbermill and completion of the North Island log sort, and \$10.3 million less proceeds on the sale of capital assets in 2003 given the sale of Earle Creek in 2002.

As at September 30, 2003, TimberWest's consolidated debt was \$252.1 million compared to total debt outstanding of \$236.5 million as at December 31, 2002. The Company's consolidated debt-to-total capitalization ratio as at September 30, 2003 was 22:78, consistent with the ratio of 21:79 as at December 31, 2002. Total debt facilities available to the Company as at September 30, 2003, were \$400.0 million, comprised of \$40.0 million available under the 364-day revolving facility due March 1, 2004, \$40.0 million available under the 364-day revolving facility due May 26, 2004, \$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.

### Offer for Sale of Tree Farm Licence 46

On September 9, 2003, the Company announced that it was putting part of its public land logging business, Tree Farm Licence 46 (TFL 46), up for sale through an auction process with qualified bidders. TFL 46 has timber rights to an annual



## TIMBERWEST FOREST CORP.

allowable cut of 499,000 m<sup>3</sup> on 83,546 hectares of Crown land, and is 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 believes an opportunity may exist to realize better value for unitholders from TFL 46 by selling it today.

Several parties have expressed an interest in the offer for sale and the Company is hopeful that a purchase and sale agreement will be concluded before the end of the fiscal year.

### Accounting Policy Change

In October 2002, the CICA Accounting Standards Board (AcSB) activated a project that would require the recognition of stock-based compensation expenses using the fair value method for all stock-based compensation transactions. In this regard, an exposure draft was issued in December 2002 proposing amendments to Section 3870, requiring recognition of expenses for all stock-based compensation transactions for fiscal years beginning on or after January 1, 2004.

The AcSB has agreed that share-based transactions should be measured on a fair value basis and, in September 2003, confirmed its intention to amend Section 3870 to require that all transactions whereby goods and services are received in exchange for stock-based compensation and other payments result in expenses that should be recognized in financial statements, and that this requirement would be applicable for financial periods beginning on or after January 1, 2004.

In anticipation of the acceptance of the recommendations of this exposure draft, the Company adopted, effective January 1, 2003, a change in its policy of accounting for stock-based compensation and now recognizes a stock-based compensation expense using the fair value method for all stock-based compensation transactions entered into on or after January 1, 2003, including both awards of Stapled Unit options and awards under the Distribution Equivalent Plan. The Company adopted the AcSB recommendations on a prospective basis and has not applied the fair value based method of accounting to Stapled Unit options granted between January 1, 2002, and December 31, 2002 (see note 10 to the accompanying unaudited interim consolidated financial statements).

### Proposed Future Accounting Standard Change

In 2001, the 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 (FASB) and the International Accounting Standards Board (IASB). 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 proposed Handbook revisions 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. The AcSB set a deadline for comments on the proposals contained in the exposure draft of August 31, 2003. Responses are currently being analyzed and the outcome of the AcSB review is expected before the end of 2003. The proposed amendments are expected to be effective for fiscal periods beginning on or after January 1, 2004, and are to be applied retroactively.

Though not yet approved, the proposals contained in the exposure draft have the potential to impact the financial statement presentation of TimberWest's Stapled Units and the distributions paid thereon, despite the fact that TimberWest's financial condition and economic underpinnings remain unchanged.

TimberWest'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. TimberWest has historically classified all components of the Stapled Unit as equity on its balance sheet as TimberWest'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 amendments proposed for Handbook Section 3860 would require the Company to reclassify the Series A Subordinate Note component of the Stapled Unit from equity to liabilities. The reclassification of the Subordinate Note component from equity to liabilities would be approximately \$685 million.

Further, holders of TimberWest Stapled Units are entitled to annual interest payments on the Subordinate Note component of approximately \$1.08. For the same reason that the Subordinate Note component is currently classified as equity on the



## TIMBERWEST FOREST CORP.

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 proposed accounting standard change would also require distributions on Stapled Units to be reported, on a pre-tax basis, as an interest expense on the statement of operations. This change would also require the tax benefit provided by the distributions to be reported as a component of the income tax provision on the statement of operations. Annual distributions on Stapled Units for fiscal 2003 are expected to be approximately \$82 million and the tax benefit recognized thereon is expected to be \$23 million. If the recommendations of the exposure draft are implemented, an estimated net charge to earnings of \$59 million would be made each year. The calculation of distributable cash generated would remain unchanged.

### Normal Course Issuer Bid

Pursuant to a normal course issuer bid, TimberWest may repurchase, in the open market through the facilities of the Toronto Stock Exchange, up to 3,809,201 Stapled Units, representing approximately 5% of the Company's issued and outstanding Stapled Units as of the date of acceptance of the bid, in the 12 months commencing November 6, 2002. As at September 30, 2003, TimberWest had not repurchased any of its Stapled Units under this bid.

### Outlook

Having come through two of the weakest quarters in our history, TimberWest is beginning to see some modest improvement in pricing for many of its products and, with the resumption of production after a period of prolonged downtime, we are beginning to see strength in overall cash flow generation.

In Japan, the rate of new housing starts over the past quarter was higher than the previous quarter. This increased demand helped expedite the reduction in the oversupply of logs and lumber in that market, however, some oversupply could persist through the balance of the year. That said, these factors have resulted in stable-to-improving log and lumber demand, which we expect to translate into improved prices for the balance of the year. If the Canadian dollar keeps pace with competing currencies, our market share in Japan should remain stable. The Company's lumber business in that market is expected to pick up for the balance of the year, particularly in the kiln-dried segment of the market.

In the US, housing starts remain strong at a seasonally adjusted annual rate of 1.6 million units and lumber prices have improved. While there is still a risk of continued oversupply, we expect stable demand for logs in this market for the balance of the year.

TimberWest's domestic log customers are largely dependent on these two major housing markets. Improvement in these markets, in conjunction with the effect of operational closures during this past summer's fire season, is expected to result in strong demand in the domestic log market through the balance of the year.

A key issue for the coastal industry this fall will be the outcome of negotiations with the Industrial, Wood and Allied Workers. We are hopeful that we will be able to modernize our collective agreement without a work stoppage.

The Company experienced an extended fire season during the third quarter with the driest summer on record. Market-related curtailments in July, combined with weather-related shutdowns in August, have created a shortfall in our quarterly and year to date production levels. We expect to recover this shortfall on our private land operations during the fourth quarter provided there are no work stoppages or additional weather-related shutdowns. At this volume level, the Company also expects to meet its private land cost reduction targets by year end. Public land logging volumes are expected to be two-thirds of planned levels. Neither planned production levels nor unit cost savings are expected to be achieved on public land operations for the year.

TimberWest expects capital expenditures to be modest for the balance of the year and expects real estate proceeds to mirror those of the third quarter.

Finally, TimberWest anticipates concluding a purchase and sale agreement for TFL 46 during this fiscal year.

Assuming no work stoppages in the fourth quarter, the Company still expects to generate sufficient distributable cash to cover its distributions for the year after normalizing for capital expenditure levels.

*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.

## Consolidated Statements of Operations

(in millions of dollars)  
Unaudited

	Three months ended September 30		Nine months ended September 30	
	2003	2002	2003	2002
Net sales	\$ 100.3	\$ 130.4	\$ 336.2	\$ 340.0
Operating costs and expenses:				
Cost of products sold	83.6	94.7	265.4	249.2
Depreciation, depletion and amortization	2.1	2.6	7.3	8.2
Selling, administrative and other	2.6	2.4	10.6	11.7
	88.3	99.7	283.3	269.1
Operating earnings	12.0	30.7	52.9	70.9
Interest expense	3.9	3.5	11.7	10.9
Amortization of deferred financing costs	0.4	0.5	1.1	3.1
Other income	(0.7)	(0.4)	(1.4)	(0.7)
Loss on bond lock transaction (note 3)	-	5.0	-	5.0
Restructuring charge (note 4)	-	-	-	9.8
	3.6	8.6	11.4	28.1
Earnings before income taxes	8.4	22.1	41.5	42.8
Income tax expense (note 5)	2.1	9.2	16.0	20.4
Net earnings for the period	\$ 6.3	\$ 12.9	\$ 25.5	\$ 22.4
Basic and diluted earnings (loss) per common share (note 6)	\$ (0.14)	\$ 0.02	\$ (0.27)	\$ (0.29)
Stapled Units outstanding at the end of the period (000's)	76,246	76,184	76,246	76,184

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

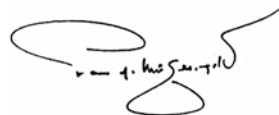
## Consolidated Balance Sheets

(in millions of dollars)

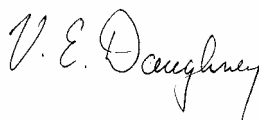
	As at September 30, 2003 <i>Unaudited</i>	As at December 31, 2002
<b>Assets</b>		
Current assets:		
Cash	\$ -	\$ 1.0
Accounts receivable	28.9	27.0
Inventories	55.2	67.3
Prepaid expenses and other current assets	3.3	2.9
Future income taxes	3.2	4.1
	<b>90.6</b>	102.3
Capital assets, net (note 7)	1,359.9	1,355.6
Other assets	18.1	20.4
	<b>\$ 1,468.6</b>	<b>\$ 1,478.3</b>
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Revolving credit facilities (note 8)	\$ 42.0	\$ -
Debentures (note 9)	-	106.5
Accounts payable and accrued liabilities	41.4	46.0
Distribution payable	20.5	20.5
	<b>103.9</b>	173.0
Revolving credit facility (note 8)	15.1	-
Debentures (note 9)	195.0	130.0
Long-term silviculture liability	4.4	4.8
Non-pension post-retirement benefits	24.5	23.7
Future income taxes	230.6	232.0
	<b>573.5</b>	563.5
Unitholders' equity:		
Stapled Units, consisting of Series A Subordinate Notes, preferred shares and common shares	870.7	870.2
Retained earnings	24.4	44.6
	<b>895.1</b>	914.8
	<b>\$ 1,468.6</b>	<b>\$ 1,478.3</b>

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 September 30		Nine months ended September 30	
	2003	2002	2003	2002
<b>Cash provided by (used in):</b>				
<b>Operating activities:</b>				
Earnings before income taxes	\$ 8.4	\$ 22.1	\$ 41.5	\$ 42.8
Cash income taxes (note 5)	(0.2)	(0.1)	(0.6)	(0.6)
	8.2	22.0	40.9	42.2
Items not involving cash:				
Depreciation, depletion and amortization	2.5	3.1	8.4	11.3
Gain on sale of capital assets	(1.5)	(3.0)	(2.8)	(3.6)
Other non-cash items	-	0.6	0.3	2.5
	9.2	22.7	46.8	52.4
Changes in non-cash working capital:				
Accounts receivable	4.1	5.9	(1.9)	10.0
Inventories	17.6	(8.0)	12.1	(7.6)
Prepaid expenses and other working capital	(0.6)	(0.9)	(0.4)	(1.6)
Accounts payable and accrued liabilities	(0.9)	(5.0)	(4.6)	8.0
	29.4	14.7	52.0	61.2
<b>Financing activities:</b>				
Distributions paid to unitholders	(20.6)	(20.5)	(61.6)	(58.3)
Issuance of Stapled Units on exercise of options	-	1.4	0.5	3.1
Issuance of Stapled Units, net	-	-	-	136.1
Decrease in overdraft facility	-	-	-	(3.6)
Increase (decrease) in revolving credit facilities	(75.7)	(6.6)	57.1	(13.5)
Issuance of 7.0% debentures	65.8	-	65.8	-
Retirement of 6.5% debentures	-	-	(106.5)	-
Deferred debt issue costs	(0.7)	-	(0.7)	-
Decrease in non-revolving credit facility	-	-	-	(137.0)
	(31.2)	(25.7)	(45.4)	(73.2)
<b>Investing activities:</b>				
Capital expenditures	(2.0)	(4.3)	(17.0)	(6.0)
Proceeds from sale of capital assets	3.0	14.5	6.9	17.2
Decrease in other assets	0.8	0.8	2.5	0.8
	1.8	11.0	(7.6)	12.0
<b>Increase (decrease) in cash</b>	-	-	(1.0)	-
<b>Cash, beginning of period</b>	-	-	1.0	-
<b>Cash, end of period</b>	\$ -	\$ -	\$ -	\$ -
<b>Supplemental information:</b>				
Interest paid	\$ 1.6	\$ 10.3	\$ 11.9	\$ 17.4
Income taxes paid	\$ 0.1	\$ 0.2	\$ 0.6	\$ 0.7

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Consolidated Statements of Unitholders' Equity

(in millions of dollars)  
Unaudited

	Stapled Units		Retained earnings	Total Unitholders' equity
	Number	Amount		
<b>For the nine months ended September 30, 2003</b>				
Balance, December 31, 2002	76,192,788	\$ 870.2	\$ 44.6	\$ 914.8
Issuance of Stapled Units on exercise of options	<b>53,334</b>	<b>0.5</b>	-	<b>0.5</b>
Net earnings	-	-	<b>25.5</b>	<b>25.5</b>
Interest on Series A Subordinate Notes	-	-	<b>(61.6)</b>	<b>(61.6)</b>
Income tax benefit thereon (note 5)	-	-	<b>15.9</b>	<b>15.9</b>
<b>Balance, September 30, 2003</b>	<b>76,246,122</b>	<b>\$ 870.7</b>	<b>\$ 24.4</b>	<b>\$ 895.1</b>
<b>For the nine months ended September 30, 2002</b>				
Balance, December 31, 2001	64,690,867	\$ 728.1	\$ 60.4	\$ 788.5
Issuance of Stapled Units, net	11,190,650	138.9	-	138.9
Issuance of Stapled Units on exercise of options	302,515	3.1	-	3.1
Net earnings	-	-	22.4	22.4
Interest on Series A Subordinate Notes	-	-	(61.2)	(61.2)
Income tax benefit thereon (note 5)	-	-	17.5	17.5
<b>Balance, September 30, 2002</b>	<b>76,184,032</b>	<b>\$ 870.1</b>	<b>\$ 39.1</b>	<b>\$ 909.2</b>

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2003

*Financial figures presented in the tables that follow are in millions of dollars, except for amounts per Stapled Unit and components thereof.*

### 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 financial statements should be read in conjunction with the Company's most recent annual consolidated financial statements. These interim financial statements follow the same accounting policies and methods of application used in the Company's audited annual consolidated financial statements of December 31, 2002, except for a change in accounting for stock-based compensation transactions as detailed below. Certain figures for previous periods have been reclassified to conform to the current period's financial statement presentation.

### 2. Accounting Policy Change

In implementing Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870 – *Stock-based Compensation and Other Stock-based Payments*, effective January 1, 2002, the Company elected to continue with its previously established policy that no compensation cost was recorded on the grant of Stapled Unit options to directors, officers or employees who are in active service or employment of the Company or of any of its subsidiaries, and complied with the requirement to provide additional disclosure of the effect of stock-based awards on net income and earnings per Stapled Unit on a pro forma basis. For awards granted under the Company's supplemental Distribution Equivalent Plan, the principles of the fair value based method of accounting for stock-based compensation were applied, and awards were accrued on a basis equal to actual distributions paid on the Company's issued and outstanding Stapled Units and are being charged to income as the underlying Stapled Unit options vest.

In October 2002, the CICA Accounting Standards Board (AcSB) activated a project that would require the recognition of stock-based compensation expenses using the fair value method for all stock-based compensation transactions. In this regard, an exposure draft was issued in December 2002 proposing amendments to Section 3870, requiring recognition of expenses for all stock-based compensation transactions for fiscal years beginning on or after January 1, 2004.

The AcSB has agreed that share-based transactions should be measured on a fair value basis and, in September 2003, confirmed its intention to amend Section 3870 to require that all transactions whereby goods and services are received in exchange for stock-based compensation and other payments result in expenses that should be recognized in financial statements, and that this requirement would be applicable for financial periods beginning on or after January 1, 2004.

In anticipation of the acceptance of the recommendations of this exposure draft, the Company changed its policy of accounting for stock-based compensation and recognizes a stock-based compensation expense using the fair value method for all stock-based compensation transactions entered into on or after January 1, 2003, including both awards of Stapled Unit options and awards under the Distribution Equivalent Plan (see note 10). The Company has adopted the recommendations of the exposure draft on a prospective basis and has not applied the fair value based method of accounting to Stapled Unit options granted between January 1, 2002, and December 31, 2002.

### 3. Loss on Bond Lock Transaction

In anticipation of the \$130.0 million aggregate principal amount 7.0% debenture public offering completed on October 1, 2002, the Company entered into a bond lock transaction to protect the Company against rising interest rates over the period of refinancing. On closing out of this transaction, due to a decline in interest rates, the Company realized a \$5.0 million loss and recorded a one-time, pre-tax charge of \$5.0 million against earnings for the quarter ended September 30, 2002.

### 4. Restructuring Charge

During the quarter ended June 30, 2002, the Company commenced a restructuring of operations with an estimated cost of \$9.8 million. As a result, a one-time, pre-tax charge of \$9.8 million was recorded in the second quarter of 2002 relating to severance and facilities closure costs.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements For the three and nine months ended September 30, 2003

### 5. Income Taxes

	Three months ended September 30		Nine months ended September 30	
	2003	2002	2003	2002
Current income tax expense				
Large corporation tax	\$ 0.2	\$ 0.1	\$ 0.6	\$ 0.6
Income tax benefit on interest on Series A Subordinate Notes charged directly to distributions	3.3	9.1	15.9	17.5
	3.5	9.2	16.5	18.1
Future income tax expense (recovery)	(1.4)	-	(0.5)	2.3
	\$ 2.1	\$ 9.2	\$ 16.0	\$ 20.4

### 6. Earnings per Share

	Three months ended September 30		Nine months ended September 30	
	2003	2002	2003	2002
Net earnings	\$ 6.3	\$ 12.9	\$ 25.5	\$ 22.4
Less: Distributions on Series A Subordinate Notes	(20.5)	(20.5)	(61.6)	(61.2)
Tax benefit thereon	3.3	9.1	15.9	17.5
	(17.2)	(11.4)	(45.7)	(43.7)
Earnings (loss) attributable to common shares	(10.9)	1.5	(20.2)	(21.3)
Basic weighted average number of common shares	76,246,122	76,118,182	76,230,564	74,180,115
Incremental common shares from potential exercise of options	65,827	130,978	74,597	146,295
Diluted weighted average number of common shares	76,311,949	76,249,160	76,305,161	74,326,410
Basic and diluted earnings (loss) per common share	\$ (0.14)	\$ 0.02	\$ (0.27)	\$ (0.29)

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.

### 7. Capital Assets

Capital assets at September 30, 2003, include \$1,244.8 million carrying value for private timberlands. This amount includes a valuation increase adjustment of \$399.3 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.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements For the three and nine months ended September 30, 2003

### 8. Revolving Credit Facilities

On March 3, 2003, the Company completed and received 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, 2004. Under this facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based loans and Canadian dollar bankers' acceptances.

On May 28, 2003, the Company completed and received 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 May 26, 2004. Under this facility, funds are available to the Company in both Canadian and US dollars by way of prime rate-based loans, LIBOR loans and Canadian dollar bankers' acceptances.

On June 27, 2003, the Company completed a two-year extension to its \$125.0 million unsecured revolving facility. This facility is now due on June 30, 2006, and continues to provide funding to the Company available in both Canadian and US dollars by way of adjusted prime rate-based loans, bankers' acceptances, US rate-based loans, LIBOR loans and letters of credit or guarantee.

As at September 30, 2003, drawings on available credit facilities included \$42.0 million under the Company's two \$40.0 million unsecured 364-day revolving facilities and \$15.1 million under the \$125.0 million unsecured revolving facility.

### 9. Debentures

	Maturity	As at September 30, 2003	As at December 31, 2002
7.0% debentures	October 1, 2007	\$ 195.0	\$ 130.0
6.5% debentures	March 3, 2003	-	106.5
		195.0	236.5
Less: Due within one year		-	(106.5)
		\$ 195.0	\$ 130.0

The Company retired \$106.5 million aggregate principal amount of its 6.5% debentures when they matured on March 3, 2003.

On September 26, 2003, the Company completed a public offering of \$65.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007. The debentures were sold at 101.28% of their principal amount, plus accrued interest of \$2.2 million from April 1, 2003, with net proceeds to the Company of \$67.3 million.

### 10. 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. Prior to January 1, 2003, the Company's policy was that no compensation cost was recorded on stock-based compensation awards granted to employees under this plan. Effective January 1, 2003, the Company changed its policy of accounting for awards under this plan and now applies the principles of the fair value based method of accounting for all stock-based compensation transactions (see note 2). The Company has made this change in accounting policy on a prospective basis and has not applied the fair value based method of accounting to Stapled Unit options granted between January 1, 2002, and December 31, 2002. The compensation cost for the 55,200 Stapled Unit options granted during the 2002 fiscal year, determined using the fair value method of accounting, is immaterial and would not have resulted in an adjustment to the Company's net earnings and earnings per common share reported for the three and nine month periods ended September 30, 2003.

The compensation cost for the 267,047 Stapled Unit options granted under the Stapled Unit Option Plan between January 1, 2003, and September 30, 2003, determined using the fair value method of accounting for stock-based compensation, is \$285,000. This amount is amortized against income over the three-year vesting period of the underlying options, resulting in a charge against earnings for the three and nine month periods ending September 30, 2003, of \$23,900 and \$63,100, respectively. The fair value of each option grant was estimated at the grant date using the Black-Scholes option pricing model with the following average assumptions: distribution yield of 9.0%; expected volatility of 25.3%; risk-free interest rate of 4.2%; and expected option life of 5 years.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements For the three and nine months ended September 30, 2003

### 10. Stock-based Compensation Plans (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. For awards granted under the supplemental Distribution Equivalent Plan, the Company applies the principles of the fair value based method of accounting for stock-based compensation. Awards are accrued on a basis equal to actual distributions paid on the Company's issued and outstanding Stapled Units and are charged to income as the underlying Stapled Unit options vest. For the three months ended September 30, 2003, \$0.3 million has been accrued for awards granted under this plan and \$0.3 million has been amortized against income for the quarter. For the nine months ended September 30, 2003, \$0.8 million has been accrued for awards granted under this plan and \$0.8 million has been amortized against income for the quarter.

During the quarter ended September 30, 2003, no Stapled Unit options were exercised, no Stapled Unit options were granted, and 1,366 options with an exercise price of \$12.84 were cancelled. For the nine months ended September 30, 2003, a total of 53,334 Stapled Unit options with an exercise price of \$8.91 were exercised, 267,047 Stapled Unit options with exercise prices ranging from \$11.90 to \$12.28 and exercisable for a period of five years from grant date were granted, and 9,367 options with exercise prices ranging from \$12.84 to \$13.03 were cancelled.

### 11. Forestry Revitalization Plan

In March 2003, the Government of BC (the "Crown") introduced its Forestry Revitalization Plan (the "Plan"), including enabling legislation through the new Forest Revitalization Act, the new Forest and Range Practices Act, and amendments to the existing Forest Act. The Plan provides for significant changes to Crown forest policy and to the existing allocation of Crown timber tenures to licensees. The changes prescribed in the Plan include the relaxing of minimum cut control regulations, the elimination of appurtenancy and timber processing regulations, more flexibility to consolidate and subdivide forest tenures, increased freedom to transfer forest tenures without restriction or penalty and a new market-based stumpage system. As well, licensees, including the Company, will be required to return 20% of their aggregate allowable annual cut to the Crown, with the first 200,000 m<sup>3</sup> exempt. The Plan states that approximately half of this volume will be redistributed to open up opportunities for woodlots, community forests and First Nations and the other half will be made available for public auction. The Crown has acknowledged that licensees will be fairly compensated for lost harvesting rights, for improvements on Crown land and for one-time costs associated with the termination of employees and contractors.

The effect of the timber take-back is expected to result in a reduction of approximately 200,000 m<sup>3</sup> of the Company's existing allowable annual cut on replaceable tenures. The effect of the Plan on the Company's financial position and results of operations cannot be determined at this time. The Company will record the effects of the Plan when they are determinable.

# TIMBERWEST FOREST CORP.

## Supplemental Information

Unaudited

Three months ended  
September 30

Nine months ended September  
30

2003

2002

2003

2002

### Sales by Product

(in millions of dollars)

Logs	\$ 76.2	\$ 99.0	\$ 270.3	\$ 274.8
Lumber	14.8	14.1	46.1	39.9
Wood chips and other	5.9	3.3	13.2	8.9
Real estate	3.4	14.0	6.6	16.4

	\$ 100.3	\$ 130.4	\$ 336.2	\$ 340.0
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### Sales Volume

Logs (thousand m <sup>3</sup> )	786.7	830.0	2,622.1	2,505.3
Lumber (million fbm)	36.5	27.2	101.1	82.7

### Production Volume

Logs (thousand m <sup>3</sup> )	669.4	859.4	2,414.3	2,590.8
Lumber (million fbm)	16.5	31.3	91.5	88.2

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

(in millions of dollars)

Net earnings	\$ 6.3	\$ 12.9	\$ 25.5	\$ 22.4
Add:				
Interest expense	3.9	3.5	11.7	10.9
Loss on bond lock transaction	-	5.0	-	5.0
Income tax expense	2.1	9.2	16.0	20.4
Depreciation, depletion and amortization	2.1	2.6	7.3	8.2
Amortization of deferred financing costs	0.4	0.5	1.1	3.1

EBITDA	\$ 14.8	\$ 33.7	\$ 61.6	\$ 70.0
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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 2.1 million to 2.5 million m<sup>3</sup> of logs, are largely located on Vancouver Island and contain some of the best coniferous forest growing sites in the world. The American Forest & Paper Association has certified that the Company is committed to managing these private lands according to sustainable forestry standards under its Sustainable Forestry Initiative (SFI)<sup>SM</sup> Program. TimberWest also owns annual Crown harvest rights of 1.3 million m<sup>3</sup> of logs, a lumbermill, and holds about 6,000 hectares of properties that 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)

