



TimberWest

Industry leader in second-growth harvesting

Q-3
2006

Third Quarter
Interim Report

For the three & nine months
ended September 30, 2006

www.timberwest.com

TSX: TWF.UN



TIMBERWEST FOREST CORP.

To Our Unitholders,

While the first half of 2006 was exceptionally strong, the third quarter has been by far our most challenging this year from a cash flow perspective. TimberWest generated \$9.3 million of distributable cash or \$0.12 per unit for the quarter compared to the third quarter of 2005 when we generated distributable cash of \$13.3 million or \$0.17 per unit after adjusting for the \$15.0 million payment to Western Forest Products to terminate a fibre supply agreement. Despite the weaker quarter, on a year-to-date basis, TimberWest has generated \$76.3 million or \$0.98 per unit compared to last year where, on an adjusted basis, we had generated \$52.6 million or \$0.68 per unit. We have generated 91% of our annual distributable cash requirements so far this year and have ended the quarter with a strong balance sheet and a debt-to-total capitalization ratio of 17%.

With the prolonged period of hot, dry weather on the coast of BC this summer, logging operations on the Company's private timberlands were shut down completely for six weeks of the thirteen week quarter. There were additional partial shutdowns on both our private and public land logging operations during the quarter compared to 2005 when we took only one week. As a result, log sales volumes were low at 616,200 m³ compared to the third quarter of 2005 when log sales volumes were 988,300 m³. Also contributing to the comparatively lower sales volumes was the fact that we started the third quarter with low log inventories. As mentioned in previous quarters, we were anticipating a downturn in North American housing starts and the consequent downward pressure on US log prices. Based on this expectation, we accelerated the log sales program to take advantage of better pricing prevailing earlier in the year. This resulted in the lower log inventories at the beginning of the third quarter.

Japan and other Asian log markets remained steady throughout this quarter. Despite the emerging weakness in US log markets, continued weakness in domestic log markets, and a weaker overall species mix for the quarter, strength in Japan helped keep log sales realizations strong at \$100 per m³, comparable to the first two quarters of this year, and well ahead of average realizations of \$87 per m³ in the third quarter of 2005. Year to date, log sales realizations were \$99 per m³ compared to year to date 2005 when they were \$91 per m³. Proportionately more of our export volume has gone to Japan this year than to our other export markets. On a year-to-date basis, 2006 log sales volumes of 2.4 million m³ are behind last year's volume of 2.6 million m³.

Our contractors have continued to experience increased cost pressures from labour shortages and higher fuel and other input costs. This has translated into higher contract rates and as a result production costs are higher by about \$3.00 per m³ than they were this time last year. We do not see this cost pressure abating in the near term and continue to work with our contractors to find efficiencies to keep costs contained. The long fire season has caused year-to-date logging production volumes to track behind last year. To the end of September 2006, log production was 2.6 million m³ compared to 2.8 million m³ to the end of September 2005.

The real estate side of our business continues to be strong with third quarter real estate sales at \$2.1 million, comparable to \$2.2 million for the same quarter last year. However, on a year-to-date basis, real estate sales are considerably ahead at \$19.0 million compared to \$4.2 million for the comparative period in 2005. The value per hectare sold continues to increase and has averaged \$26,000 this year. This compares to a 2005 year-to-date average of approximately \$15,000 per hectare and to an overall historical average of approximately \$10,000 per hectare. With our intention to expand our real estate business, we continue to develop our plans and look at ways to maximize the value of this part of our business for our unitholders. One key initiative undertaken during the quarter was the launch of an external search for a new Vice President of Real Estate to add depth and industry expertise to our senior management team. We look forward to updating you on our real estate plans as they are finalized and we build the internal capacity to surface the value of these assets.

A second organization change during the quarter was the appointment of Bev Park to the newly created position of Executive Vice President and Chief Financial Officer. In addition to her traditional CFO role, Bev assumes added responsibilities across all business units and in the areas of strategy formulation, business development, information technology, and human resources. Bev is also leading the new real estate business unit until such time as the new VP, Real Estate is appointed.

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With lumber markets remaining strong in Japan, the Elk Falls Sawmill has generated sales revenues on a year-to-date basis that are approximately 40% higher than the comparable period last year when the sawmill took five weeks of downtime. The sales process for the Elk Falls sawmill, our only remaining sawmill, is still underway. We are hopeful a successful sale can be concluded, but there is no certainty this will materialize.

In August 2006, WorkSafe BC released its investigative report on the tragic death of Ted Gramlich who was hand falling on TimberWest's land for one of our contractors in November 2005. Even though WorkSafe BC concluded that a 'lapse in judgment' by the logger himself was the primary cause of the fatality, it is the Company's duty to regularly review safety procedures, to continue to make improvements, and to follow through in making sure improvements are implemented.

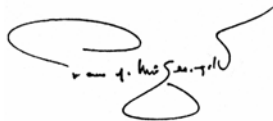
Subsequent to the WorkSafe BC report, a Coroner's Inquest was held into this fatality. TimberWest actively participated in this very important inquest, the purpose of which was to make recommendations that will improve industry-wide safety practices. To this end, the Coroner and the jury made 23 recommendations, five of which were directed to TimberWest. We are currently determining how best to implement these recommendations and will make a public announcement over the next few weeks addressing the implementation plan. This inquest has been a major focus for our organization and I would like to thank all of our timberland employees who so diligently prepared for the inquest, gave testimony and otherwise contributed to the process.

TimberWest has a practice of continuously improving safety performance and has made a number of improvements to its Contractor Safety Management System during the year. We have engaged Phil Halkett, the former Deputy Minister of Forests and Deputy Minister to the Premier, and Dave Haggard, the former President of the IWA Canada, to carry out a review of our Contractor Safety Management System, our action plans to address the Coroner's recommendations, and our safety program with the BC Forest Safety Council. This report is expected to be made public at the end of November 2006. Our sole aim is to improve the safety practices of everyone who works on TimberWest's land base and at our sawmill. While safety performance has been better across TimberWest's operations in 2006, and throughout the industry, we can always make improvements and that is what we will continue to do.

The Canada/US softwood lumber agreement was implemented on October 12, 2006. TimberWest will receive approximately \$3.2 million in refunded duties and interest, which is expected to be received in late 2006 or 2007. The Company continues to wait for a decision by the Federal Court on our Notice 102 legal challenge.

As we go into the final quarter of the year, we remain confident that TimberWest will generate enough distributable cash from its operations to cover its distribution requirements for 2006.

On behalf of the Board of Directors



Paul J. McElligott
President and Chief Executive Officer

Vancouver, British Columbia
October 26, 2006

TIMBERWEST FOREST CORP.

Management's Discussion and Analysis

For the three and nine months ended September 30, 2006 and 2005

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 2006. 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 2006 relative to the third quarter and year to date of 2005, and that have affected the Company's financial position as at September 30, 2006, relative to December 31, 2005. 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 2005 Annual Report.

TimberWest's unaudited interim consolidated financial statements and the accompanying notes included within this interim report include the accounts of TimberWest Forest Corp. and its subsidiaries. The unaudited interim consolidated financial statements and the accompanying notes are prepared in accordance with Canadian generally accepted accounting principles (GAAP) and are expressed in Canadian dollars.

This Management's Discussion and Analysis has been prepared based on information available as at October 26, 2006.

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

<i>(in millions of dollars)</i>	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Net earnings (loss)	\$ (12.8)	\$ (17.0)	\$ 2.3	\$ (26.1)
Interest on Series A Subordinate Notes owned by unitholders	20.9	20.8	62.7	62.4
Earnings available for distribution	8.1	3.8	65.0	36.3
Future income tax recovery	(0.8)	(10.7)	(25.0)	(10.6)
Earnings (loss) available for distribution before provision for future income taxes	7.3	(6.9)	40.0	25.7
Add (deduct):				
Depreciation, depletion and amortization	2.1	2.5	6.8	7.2
Proceeds from sale of property, plant and equipment	2.2	2.4	19.1	33.0
(Gain) loss on sale of property, plant and equipment	(1.3)	0.1	(4.0)	(6.2)
Additions to property, plant and equipment	(2.2)	(0.2)	(3.7)	(22.5)
Other non-cash items	1.2	0.4	18.1	0.4
	2.0	5.2	36.3	11.9
Distributable cash	\$ 9.3	\$ (1.7)	\$ 76.3	\$ 37.6
Per Stapled Unit amounts: <i>(in dollars)</i>				
Basic and diluted earnings (loss) available for distribution before provision for future income taxes per weighted average Stapled Unit	\$ 0.09	\$ (0.09)	\$ 0.52	\$ 0.33
Basic and diluted distributable cash per weighted average Stapled Unit	\$ 0.12	\$ (0.02)	\$ 0.98	\$ 0.49
Cash distributions paid per Stapled Unit	\$ 0.27	\$ 0.27	\$ 0.81	\$ 0.81

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The following table provides a reconciliation of cash flow from operations before changes in working capital to distributable cash:

<i>(in millions of dollars)</i>	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Cash flow from operations before changes in working capital	\$ (11.2)	\$ (24.1)	\$ (1.7)	\$ (33.9)
Add (deduct):				
Interest on Series A Subordinate Notes owned by unitholders	20.9	20.8	62.7	62.4
Proceeds from sale of property, plant and equipment	2.2	2.4	19.1	33.0
Additions to property, plant and equipment	(2.2)	(0.2)	(3.7)	(22.5)
Other non-cash items	(0.4)	(0.6)	(0.1)	(1.4)
	20.5	22.4	78.0	71.5
Distributable cash	\$ 9.3	\$ (1.7)	\$ 76.3	\$ 37.6

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

Earnings available for distribution and distributable cash are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that the presentation of these measures will enhance an investor's understanding of the Company's operating performance. 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:

	2006	2005	2004	2003	2002	2001
Distributable Cash <i>(in millions of dollars)</i>						
First quarter	\$ 31.5	\$ 23.9	\$ 27.7	\$ 25.7	\$ 21.2	\$ 25.9
Second quarter	35.5	15.4	43.5	4.7	10.6	26.7
Third quarter	9.3	(1.7)	35.9	12.0	34.1	14.1
Fourth quarter		29.7	18.1	9.0	24.2	16.8
	\$ 76.3	\$ 67.3	\$ 125.2	\$ 51.4	\$ 90.1	\$ 83.5
Distributable Cash per Stapled Unit ¹ <i>(in dollars)</i>						
First quarter	\$ 0.41	\$ 0.31	\$ 0.36	\$ 0.34	\$ 0.30	\$ 0.40
Second quarter	0.46	0.20	0.57	0.06	0.14	0.41
Third quarter	0.12	(0.02)	0.47	0.15	0.45	0.22
Fourth quarter		0.38	0.24	0.12	0.32	0.26
	\$ 0.98	\$ 0.87	\$ 1.64	\$ 0.67	\$ 1.21	\$ 1.29

¹ Per Stapled Unit amounts by quarter do not necessarily add to the total of the year and year-to-date due to changes in the weighted average number of Stapled Units outstanding during the year.

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Quarterly Financial Highlights

TimberWest generated distributable cash of \$9.3 million or basic and diluted distributable cash of \$0.12 per weighted average Stapled Unit for the three months ended September 30, 2006, compared to negative distributable cash of \$1.7 million or basic and diluted negative distributable cash of \$0.02 per weighted average Stapled Unit for the same period in 2005. The variance in distributable cash from the prior year period can be primarily attributed to a payment of \$15.0 million made in the third quarter of 2005 to terminate a fibre supply agreement, offset in part by reduced operating earnings in 2006 due to lower log sales compared to the prior year period. Earnings available for distribution for the three months ended September 30, 2006, before provision for future income taxes, were \$7.3 million or \$0.09 per basic and diluted weighted average Stapled Unit compared to negative earnings available for distribution before provision for income taxes of \$6.9 million or \$0.09 per basic and diluted weighted average Stapled Unit for the comparative period in 2005.

Sales for the three months ended September 30, 2006, were \$97.3 million compared to sales of \$119.2 million reported for the comparative period in 2005. Operating earnings were \$11.3 million or 12% of sales for the third quarter of 2006 compared to \$14.0 million or 12% of sales for the same period in 2005. The decline in both sales and operating earnings reflect a 29% decrease in log sales in 2006 compared to the prior year period. Average realizations on log sales for the quarter were up 15% primarily due to stronger pricing, a better species and end use sort mix, and higher volumes to Japan compared to the same period in 2005. However, log sales volumes were down 38% primarily due to a prolonged period of hot, dry weather on the coast of BC during the quarter which resulted in logging operations on the Company's private timberlands being shut down completely for six weeks, with partial shutdowns taken across the Company's entire land base. This compares to a one-week suspension in 2005. The Company recorded a \$0.5 million non-cash pension expense in the third quarter of 2006 related to the annuitization and transfer of certain pension plan obligations to a financial institution during the quarter (see Highlights and Significant Transactions – *Pension Plan Annuitization*). Earnings results for the third quarter of 2005 reflect a \$15.0 million payment made in that period to terminate a fibre supply agreement. Earnings before interest, taxes, depreciation and amortization (EBITDA)² for the three months ended September 30, 2006, were \$13.0 million or \$0.17 per basic and diluted weighted average Stapled Unit compared to \$0.2 million or nil per basic and diluted weighted average Stapled Unit for the comparative period in 2005. The Company reported an income tax recovery of \$0.8 million for the three months ended September 30, 2006, representing a non-cash future income tax recovery. The Company incurred a net loss for the three months ended September 30, 2006, of \$12.8 million, equating to basic net loss of \$0.17 per weighted average common share and diluted net loss of \$0.16 per weighted average common share, compared to a net loss of \$17.0 million or a basic and diluted net loss of \$0.22 per weighted average common share for the comparative period in 2005.

Year to Date Financial Highlights

TimberWest generated distributable cash of \$76.3 million or basic and diluted distributable cash of \$0.98 per weighted average Stapled Unit for the nine months ended September 30, 2006, compared to distributable cash of \$37.6 million or basic and diluted distributable cash of \$0.49 per weighted average Stapled Unit for the same period in 2005. Distributable cash in the current year has benefited from strong operating results for the first nine months of 2006, including higher average realizations on log and lumber sales due to a richer sales mix and improved pricing offset partially by higher costs, as well as increased real estate activity in the first nine months of 2006, which generated proceeds from real estate sales of \$19.0 million compared to proceeds of \$4.2 million for the prior year period. As noted under the quarterly financial highlights, the increase in distributable cash from the prior year period can also be attributed in part to a payment of \$15.0 million made in the third quarter of 2005 to terminate a fibre supply agreement. Also noteworthy is that distributable cash results for the first nine months of 2005 reflect unusual property, plant and equipment transactions, including the buy-out of leases on company-operated logging equipment for \$21.0 million and the subsequent sale of this leased equipment and other company-owned logging equipment to long-term contractors for proceeds of approximately \$25.1 million as part of the 2005 business transformation initiative. Earnings available for distribution for the nine months ended September 30, 2006, before provision for future

² EBITDA is a measure that does not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. Management believes that the presentation of this measure will enhance an investor's understanding of the Company's operating performance. A reconciliation of net earnings (loss) as determined in accordance with GAAP and EBITDA is provided in the supplemental information appended to this interim report.

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income taxes, were \$40.0 million or \$0.52 per basic and diluted weighted average Stapled Unit compared to \$25.7 million or \$0.33 per basic and diluted weighted average Stapled Unit for the comparative period in 2005.

Sales for the nine months ended September 30, 2006 were \$369.2 million compared to sales of \$325.4 million reported for the comparative period in 2005. Operating earnings were \$69.2 million or 19% of sales for the nine months of 2006 compared to \$49.1 million or 15% of sales for the same period in 2005. The year over year strengthening of the operating margin primarily reflects higher average realizations on log and lumber sales, which were up 9% and 18%, respectively, and an increase in lumber sales volumes, up 18%, offset in part by a 7% decrease in log sales volumes, compared to the same period in 2005. A combination of improved log pricing and a richer end use sort mix during the first nine months of 2006 more than offset the adverse currency effects of a strong Canadian dollar, contributing to the higher sales realizations in the current year period. Gains realized in the first half of the year by increasing harvest levels to take advantage of strong markets were virtually eliminated as the result of logging operations on the Company's private timberlands being shut down completely for six weeks, with partial shutdowns taken across the Company's entire land base in the third quarter of 2006 due to high or extreme forest fire hazard. Year-to-date results reflect a \$17.7 million non-cash pension expense related to the annuitization and transfer of certain pension plan obligations completed during the second and third quarters of the year. Year-to-date earnings results for 2005 reflect a \$15.0 million payment made in that period to terminate a fibre supply agreement. EBITDA for the nine months ended September 30, 2006, were \$58.0 million or \$0.75 per basic and diluted weighted average Stapled Unit compared to \$45.4 million or \$0.59 per basic and diluted weighted average Stapled Unit for the comparative period in 2005. The Company reported an income tax recovery of \$24.8 million for the nine months ended September 30, 2006, including a non-cash future income tax recovery of \$25.0 million comprised primarily of a \$14.8 million recovery to reflect the effect of changes in Canadian federal income tax rates that were substantively enacted during the second quarter of 2006, and a \$5.8 million recovery arising from the pension plan annuitization transaction completed in the second quarter of 2006. Net earnings for the nine months ended September 30, 2006, were \$2.3 million, equating to basic and diluted net earnings of \$0.03 per weighted average common share, compared to a net loss of \$26.1 million or a basic and diluted net loss of \$0.34 per weighted average common share for the comparative period in 2005.

Subsequent Event – Softwood Lumber Dispute

Effective October 12, 2006, the governments of Canada and the United States have agreed to terms to resolve the softwood lumber dispute under the Softwood Lumber Agreement. On October 19, 2006, the United States Department of Commerce revoked all existing anti-dumping and countervailing duty orders on softwood lumber shipped to the United States from Canada and ordered the liquidation of the duties collected from May 22, 2002 with interest. By agreement, U.S. \$1 billion will be retained by the U.S. Government for distribution to certain U.S. interests and the remaining duty deposits will be refunded to Canadian interests. The Softwood Lumber Agreement requires that an export tax be collected by the government of Canada, which is based upon the price and volume of lumber shipped. Canada implemented the export tax on October 12, 2006, however, the export tax legislation requires approval by the Parliament of Canada before becoming law.

The Company anticipates receiving approximately \$3.2 million in refunded duties and interest, which is expected to be received in late 2006 or 2007.

Highlights and Significant Transactions

Pension Plan Annuitization

In the second quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for all retirees in the Company's salaried employee defined benefit pension plans. Effective April 15, 2006, \$89.7 million of pension obligations were transferred to the financial institution at a cost to the Company of \$1.1 million. In addition, the Company recorded a \$17.2 million non-cash pension expense in the second quarter of 2006 related to this transaction, representing the unamortized net actuarial loss associated with retiree pension obligations at the transaction date that would have otherwise been amortized over the expected life of the pension plan.

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In the third quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for members of one of the Company's remaining small defined benefit pension plans. Effective July 14, 2006, \$1.0 million of pension obligations and \$1.4 million of pension assets were transferred to the financial institution. As this pension plan was in a surplus position at the time of this transaction there was no cash cost to the Company, however, the Company recorded a \$0.5 million non-cash pension expense in the third quarter of 2006, representing the settlement loss on finalization of this transaction.

TimberWest believes these transactions provide security for retirees, while eliminating an encumbrance from its business at a minimal cost.

Cash Distribution

On October 26, 2006, TimberWest announced a distribution of \$0.269 per Stapled Unit, payable January 15, 2007, to unitholders of record on January 1, 2007. From inception to September 30, 2006, the Company has generated distributable cash of \$740.4 million while, including the October 15, 2006 distribution of \$20.9 million, the Company has paid out \$712.8 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, 2006, were \$61.6 million, down 29% from log sales of \$86.4 million for the quarter ended September 30, 2005. This decrease reflects a 38% decrease in log sales volume, with 616,200 m³ of logs sold in the third quarter of 2006, offset in part by a 15% increase in overall log sales realizations, averaging \$100 per m³ for the third quarter of 2006. Log sales volumes into the domestic market were down 38% or 206,900 m³ over the comparative period in 2005. Export log sales volumes were down 37% or 165,200 m³ over the comparative period in 2005, reflecting a 13% decrease in volumes sold into all Asian markets and a 56% decrease in volumes sold into the US. The significant reduction in log sales volumes can primarily be attributed to lower levels of product available for sale as logging operations on the Company's private timberlands were shut down completely for six weeks, with partial shutdowns taken across the Company's entire land base in the third quarter of 2006 due to high or extreme forest fire hazard, compared to a one-week suspension in 2005. As a result of this curtailment, harvest volumes in the third quarter of 2006 were only 592,600 m³, 44% lower than volumes in the comparative period of 2005. Pricing levels in the third quarter of 2006 were supported by both a lower supply of logs in many of the Company's market segments and a stronger sales mix, with average domestic sales realizations increasing 16% to \$80 per m³, and average export sales realizations increasing 12% to \$125 per m³. The operating margin from timberland operations averaged 20% of log sales for the third quarter of 2006, comparable to 21% of log sales for the third quarter of 2005, a result that reflects the net effect of lower log sales volumes, higher average log sales realizations and higher costs.

Log sales for the nine months ended September 30, 2006, were \$241.3 million, comparable to log sales of \$239.1 million for the nine months ended September 30, 2005. This result reflects the net effect of a 9% increase in overall log sales realizations, averaging \$99 per m³ for the first nine months of 2006, offset by a 7% decrease in log sales volume, with 2,443,000 m³ of logs sold in the first nine months of 2006. The Canadian dollar was approximately 8% stronger relative to the US dollar during the first nine months of 2006 compared to the same period in 2005, and continued to negatively affect realizations. However, a combination of improved log pricing and a richer end use sort mix during the first nine months of 2006 more than offset the currency effects and contributed to higher sales realizations in the current year period. On a year-to-date basis, log sales volumes into the domestic market were down 16% over the comparative period in 2005. Export log sales volumes were up 4% or 51,400 m³ over the comparative period in 2005, reflecting a 25% increase in volumes sold into all Asian markets, offset in part by a 19% decrease in volumes sold into the US. Export sales to Asian markets represented 64% of total exports compared to 53% of total export sales in the comparative period of 2005. Some of the increased export volume in 2006 can be attributed to fibre freed up as the result of the repurchase of a fibre supply agreement in late 2005. The flexibility provided by TimberWest's private timberland asset base allowed the Company to take advantage of strong markets early in the first half of the year by increasing harvest levels. However, most of the gains realized in the first half of the year were eliminated as the result of logging operations on the Company's private timberlands

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being shut down completely for six weeks, with partial shutdowns taken across the Company's entire land base due to high or extreme forest fire hazard. Year to date, average log sales realizations for 2006 were boosted by a sales mix more heavily weighted in higher-value Douglas fir. The operating margin from timberland operations for the first nine months of 2006 averaged 32% of log sales, compared to 28% of log sales for the comparative period in 2005. The improved results for 2006 reflect the effects of higher average log sales realizations discussed previously, offset in part by an increase in production costs, coming in at \$66 per m³, compared to \$63 per m³ for the comparative period in 2005, much of the increase in unit costs being attributed to the significantly lower harvest volumes in the third quarter of 2006 and higher contractor rates.

Lumber sales for the three months ended September 30, 2006, of \$27.6 million were 21% higher than sales of \$22.9 million for the quarter ended September 30, 2005. This increase reflects a 21% increase in average lumber sales realizations compared to the same period in 2005, offset in part by a 3% decrease in lumber volumes sold. Higher sales realizations in the third quarter of 2006 reflect continued strength in demand from Japan due to short supply in that market. Production at the sawmill was 45.8 million board feet of lumber in the third quarter of 2006, down slightly from 47.4 million board feet for the same period of 2005.

Lumber sales for the nine months ended September 30, 2006, of \$89.5 million were 40% greater than sales of \$64.1 million for the first nine months of 2005. This increase reflects an 18% increase in lumber volumes sold and an 18% increase in average lumber sales realizations compared to the same period in 2005. On a year-to-date basis, the sawmill has benefited from improved demand in the Japanese market due to short supply in that market. In addition, the sawmill has benefited from its ability to maintain consistent supply to customers through the first nine months of 2006, a time when many competitors were taking downtime. Production at the sawmill was 141.9 million board feet of lumber in the first nine months of 2006, up approximately 15% compared to production in the same period of 2005, reflecting the effect of five weeks of market-related downtime taken during the second quarter of 2005.

Wood chip sales for both the three and nine month periods ended September 30, 2006, of \$3.2 million and \$9.7 million, respectively, were tracking or ahead of sales for the comparative periods in 2005 of \$3.2 million and \$8.0 million, respectively, reflecting greater chip volumes available for sale due to increased production at the sawmill, offset in part by slightly lower average chip sales realizations.

Real estate activity for the third quarter of 2006 generated revenues of \$2.3 million compared to revenues of \$2.4 million for the comparative period in 2005. Sales of higher use properties netted proceeds of \$2.1 million for the quarter, comparable to proceeds of \$2.2 million for the same period in 2005. On a year-to-date basis, real estate activity generated revenues of \$21.0 million, well ahead of the \$4.9 million generated for the first nine months of 2005. Proceeds from the sale of higher use properties for the nine months ended September 30, 2006, were \$19.0 million compared to \$4.2 million for the comparative period in 2005.

Financial Position

Current assets decreased \$12.1 million to \$76.7 million at September 30, 2006, down from \$88.8 million as at December 31, 2005. Cash and cash equivalents increased \$7.3 million to \$10.3 million at September 30, 2006, reflecting strong year-to-date cash flows from operations and the sale of higher use properties. Inventories were \$42.4 million at September 30, 2006, down from \$48.2 million as at December 31, 2005, reflecting significantly lower log harvest volumes in the third quarter of 2006 as logging operations on the Company's private timberlands were shut down completely for six weeks, with partial shutdowns taken across the Company's entire land base due to high or extreme forest fire hazard, with log production down 44% over the comparative period in 2005. Accounts receivable were \$13.1 million at September 30, 2006, down from \$23.9 million as at December 31, 2005, primarily reflecting the effects of low log sales in the third quarter of 2006. Prepaid expenses and other current assets and the future income tax asset at September 30, 2006, have decreased slightly from December 31, 2005.

Property, plant and equipment were \$1,300.6 million as at September 30, 2006, \$17.8 million less than as at December 31, 2005. This decrease primarily reflects the sale of property, plant and equipment with a net book value of \$15.1 million during the first nine months of 2006, including higher and better use properties, as well as a provision for depreciation of capital assets of \$6.4 million recorded during this period. These items were offset in part by year to date capital additions of \$3.7 million, comprised primarily of a new log inventory management system and logging roads.

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Other assets were \$2.7 million at September 30, 2006, down from the balance of \$11.9 million at December 31, 2005. Of note is the elimination of an \$8.3 million prepaid pension benefit asset from other assets as a result of the transfer of pension obligations to financial institutions on the annuitization and transfer of certain pension obligations that were completed in the second and third quarters of 2006 (see Highlights and Significant Transactions – *Pension Plan Annuitization*).

Current liabilities as at September 30, 2006, were \$60.1 million compared to \$51.0 million as at December 31, 2005. This variance can be attributed to a \$9.1 million increase in accounts payable and accrued liabilities, including a \$6.8 million accrual at September 30, 2006 for the semi-annual interest payment on the Company's \$195.0 million debentures.

As at September 30, 2006, the Company had no borrowings on its available credit facilities and had commitments of \$16.9 million relating to outstanding letters of credit, including \$16.3 million issued under its demand bank guarantee facility and \$0.6 million issued under its \$100.0 million long-term unsecured revolving facility.

Long-term financial liabilities as at September 30, 2006, were comprised of \$195.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007.

Other long-term liabilities as at September 30, 2006, included a silviculture liability of \$3.7 million, a \$38.5 million liability relating to employee future benefits and a future income tax liability of \$159.6 million. The silviculture liability at September 30, 2006, is comparable to the balance of \$3.2 million as at December 31, 2005. The \$9.9 million increase in employee future benefits from the balance of \$28.6 million at December 31, 2005, can be attributed to a reclassification of the liability for certain pension obligations as a result of the annuitization of certain pension obligations (see Highlights and Significant Transactions – *Pension Plan Annuitization*). The \$25.3 million decrease in the liability for future income taxes from the balance of \$184.9 million at December 31, 2005, is primarily attributable to a \$14.8 million future income tax recovery recorded in the second quarter of 2006 to reflect the effects of changes in Canadian federal income tax rates that were substantively enacted during the quarter and a \$5.8 million future income tax recovery arising from the pension plan annuitization transaction completed in the second quarter of 2006.

The Series A Subordinate Note component of the Company's Stapled Unit is presented as a liability on the Company's consolidated balance sheets. As at September 30, 2006, the Series A Subordinate Note liability was \$696.6 million.

During the quarter ended September 30, 2006, options to purchase 53,425 Stapled Units were exercised for proceeds of \$0.7 million and 5,637 options were cancelled. During the nine months ended September 30, 2006, 245,238 Stapled Unit options were granted, options to purchase 95,517 Stapled Units were exercised for proceeds of \$1.2 million and 5,637 options were cancelled. As at October 26, 2006, the Company had 999,563 granted and outstanding Stapled Unit option awards and 77,583,088 issued and outstanding Stapled Units.

Cash Flow and Liquidity

Cash used in operations before changes in non-cash working capital for the three months ended September 30, 2006, was \$11.2 million or \$0.14 per weighted average Stapled Unit compared to cash used in operations before changes in non-cash working capital of \$24.1 million or \$0.31 per weighted average Stapled Unit for the same period in 2005. During the third quarter of 2006, non-cash working capital decreased by \$10.4 million compared to a \$6.5 million decrease reported for the same period in 2005. The current period decrease reflects the net effect of a decrease in accounts receivable, inventories and prepaid expenses and other working capital, offset in part by an decrease in accounts payable and accrued liabilities, compared to balances at December 31, 2005.

Cash used in operations before changes in non-cash working capital for the nine months ended September 30, 2006, was \$1.7 million or \$0.02 per weighted average Stapled Unit compared to cash used in operations before changes in non-cash working capital of \$33.9 million or \$0.44 per weighted average Stapled Unit for the corresponding period in 2005. For the nine months ended September 30, 2006, non-cash working capital decreased \$28.3 million compared to an \$11.1 million increase for the same period in 2005. The current year decrease reflects the effect of a decrease in accounts receivable, inventories, prepaid expenses

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and other working capital and an increase in accounts payable and accrued liabilities, compared to balances at December 31, 2005.

Net cash provided by financing activities during the three months ended September 30, 2006, was \$0.7 million compared to \$13.9 million provided by financing activities in the comparative period of 2005. During the three months ended September 30, 2006, the Company issued 53,425 Stapled Units on the exercise of Stapled Unit options for net proceeds of \$0.7 million, compared to the issuance of 10,218 Stapled Units on the exercise of Stapled Unit options for net proceeds of \$0.2 million in the comparative period of 2005. During the third quarter of 2006, there were no borrowings on available credit facilities, whereas \$13.7 million was borrowed on available credit facilities in the comparative period in 2005.

Net cash used in financing activities during the nine months ended September 30, 2006 was \$35.8 million compared to \$32.4 million provided by financing activities in the comparative period of 2005. During the nine months ended September 30, 2006, the Company issued 95,517 Stapled Units for net proceeds of \$1.2 million on the exercise of Stapled Unit options, compared to the issuance of 368,064 Stapled Units for net proceeds of \$4.4 million on the exercise of Stapled Unit options in the comparative period in 2005. In addition, during the first nine months of 2006, \$37.0 million was applied to reduce amounts borrowed on available credit facilities compared to \$28.0 million borrowed on available credit facilities during the same period in 2005.

Net cash provided by investing activities during the three months ended September 30, 2006, was \$0.2 million compared to \$3.7 million provided by investing activities during the comparative period of 2005. In the third quarter of 2006, the Company received net proceeds of \$2.2 million from the sale of property, plant and equipment, primarily from the sale of higher use properties, and incurred \$2.2 million for capital expenditures, primarily for the implementation of a new log inventory management system and the construction of logging roads.

Net cash provided by investing activities for the nine months ended September 30, 2006, was \$16.5 million compared to net cash provided by investing activities of \$11.0 million for the same period of 2005. During the first nine months of 2006, the Company received net proceeds of \$19.1 million from the sale of property, plant and equipment, primarily from the sale of higher use properties, and incurred \$3.7 million for capital expenditures, primarily for the construction of logging roads and for the implementation of a new log inventory management system. Comparative figures for 2005 reflect transactions related to the business transformation initiative completed during that period, including \$21.0 million for the buy-out of leases on Company-operated logging equipment which was subsequently sold to the Company's new long-term contractors, with the Company receiving approximately \$25.1 million in proceeds from the sale of both leased and Company-owned logging equipment. In addition, proceeds from the sale of property, plant and equipment for the comparative period of 2005 included \$3.7 million in proceeds received in connection with the timber reallocation agreement with the Province that was finalized in the first quarter of that year.

As at September 30, 2006, TimberWest's total debt³ outstanding was \$195.0 million compared to total debt outstanding of \$232.0 million as at December 31, 2005. The Company's consolidated debt-to-total capitalization ratio³ as at September 30, 2006 was 17:83, compared to 20:80 as at December 31, 2005.

Total debt facilities available to the Company as at September 30, 2006, were \$386.3 million, comprised of \$10.0 million available under a demand operating credit facility, \$16.3 million available under a demand bank guarantee facility, \$65.0 million available under a revolving facility due July 7, 2010, \$100.0 million available under a revolving facility due July 27, 2010 and \$195.0 million of 7.0% debentures maturing on October 1, 2007. As at September 30, 2006, the Company had commitments of \$16.9 million relating to outstanding letters of credit issued to secure various obligations of the Company, including \$16.3 million issued under its demand bank guarantee facility and \$0.6 million issued under its \$100.0 million long-term unsecured revolving facility.

³ Total debt and the debt-to-total capitalization ratio are measures that do not have a standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. As the Company's Series A Subordinate Notes trade only as part of the Company's equity instrument, the Stapled Unit, they are not included in the Company's definition of debt. Management believes that the presentation of these measures will enhance an investor's understanding of the Company's financial resources and capital structure.

TIMBERWEST FOREST CORP.

Quarterly Financial Information

The following table presents selected unaudited quarterly financial information for each of the Company's last eight quarters. This data has been derived from unaudited interim consolidated financial statements that have been prepared on the same basis as the 2005 annual audited consolidated financial statements. In the Company's opinion, the amounts include all normal recurring adjustments necessary for the fair presentation of such information. These financial results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

<i>(in millions of dollars, except per common share and per Stapled Unit amounts)</i>	2004		2005				2006		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
Sales	\$ 114.9	\$ 98.6	\$ 107.6	\$ 119.2	\$ 132.8	\$ 126.3	\$ 145.6	\$ 97.3	
Operating earnings	\$ 15.0	\$ 17.3	\$ 17.8	\$ 14.0	\$ 21.0	\$ 25.3	\$ 32.6	\$ 11.3	
Net earnings (loss)	\$ (1.2)	\$ (2.4)	\$ (6.7)	\$ (17.0)	\$ 30.9	\$ 2.9	\$ 12.2	\$ (12.8)	
Earnings available for distribution	\$ 19.5	\$ 18.4	\$ 14.1	\$ 3.8	\$ 51.8	\$ 23.8	\$ 33.1	\$ 8.1	
Earnings available for distribution before provision for future income taxes	\$ 13.2	\$ 19.6	\$ 13.0	\$ (6.9)	\$ 24.3	\$ 21.2	\$ 11.5	\$ 7.3	
Distributable cash	\$ 18.1	\$ 23.9	\$ 15.4	\$ (1.7)	\$ 29.7	\$ 31.5	\$ 35.5	\$ 9.3	
Distributions paid	\$ 20.6	\$ 20.7	\$ 20.8	\$ 20.8	\$ 20.8	\$ 20.9	\$ 20.9	\$ 20.9	
<i>\$ per common share</i> ⁴									
Basic net earnings (loss)	\$ (0.02)	\$ (0.03)	\$ (0.09)	\$ (0.22)	\$ 0.40	\$ 0.04	\$ 0.16	\$ (0.17)	
Diluted net earnings (loss)	\$ (0.02)	\$ (0.03)	\$ (0.09)	\$ (0.22)	\$ 0.40	\$ 0.04	\$ 0.16	\$ (0.16)	
<i>\$ per Stapled Unit</i> ⁴									
Basic and diluted earnings available for distribution	\$ 0.25	\$ 0.24	\$ 0.18	\$ 0.05	\$ 0.67	\$ 0.31	\$ 0.43	\$ 0.10	
Basic and diluted earnings available for distribution before provision for future income taxes	\$ 0.17	\$ 0.25	\$ 0.17	\$ (0.09)	\$ 0.31	\$ 0.27	\$ 0.15	\$ 0.09	
Basic and diluted distributable cash	\$ 0.24	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.41	\$ 0.46	\$ 0.12	
Distributions paid	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	

⁴ Per common share and per Stapled Unit amounts presented for each quarter have been determined based on the weighted average number of common shares or weighted average number of Stapled Units outstanding during the quarter. Per common share and per Stapled Unit amounts by quarter do not necessarily add to the total of the year due to changes in the weighted average number of common shares and Stapled Units outstanding during the year.



TIMBERWEST FOREST CORP.

Outlook

As we go into the final quarter of the year, economic reports indicate that the US housing market is softening, unsold housing inventories increasing, housing prices on average starting to drop and high lumber inventories. With US lumber prices declining below many producers' cash costs, we are expecting to see more downward pressure on US log prices in the upcoming quarter. Many mills that supply this market are starting to take downtime but we expect it will be more than a quarter before supply diminishes enough to impact pricing.

The Japanese housing market remains strong and this will help TimberWest mitigate sales weakness in the US. Real estate sales are also expected to continue at higher levels than we have had in the past.

We are confident that the Company will generate enough distributable cash from its operations to cover its distribution requirements for 2006.

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 for TimberWest's forest products, changes in real estate market conditions in the areas where TimberWest's higher use properties are located, actions of competitors, interest rate and foreign currency fluctuations, regulatory, harvesting fee and trade policy changes and other actions by governmental authorities, the ability to implement business strategies and pursue business opportunities, labour relations, weather conditions, forest fires, insect infestation, disease and other natural phenomena and other risks and uncertainties described in TimberWest's public filings with securities regulatory authorities.



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 September 30		Nine months ended September 30	
	2006	2005	2006	2005
Sales	\$ 97.3	\$ 119.2	\$ 369.2	\$ 325.4
Operating costs and expenses:				
Cost of products sold	80.9	98.6	283.0	258.8
Depreciation, depletion and amortization	2.0	2.3	6.4	6.6
Selling, administrative and other	3.1	4.3	10.6	10.9
	86.0	105.2	300.0	276.3
Operating earnings	11.3	14.0	69.2	49.1
Interest expense:				
Series A Subordinate Notes owned by unitholders	20.9	20.8	62.7	62.4
Long-term debt	3.6	4.3	11.0	10.8
Short-term debt	—	0.1	—	1.1
	24.5	25.2	73.7	74.3
Amortization of deferred financing costs	0.1	0.2	0.4	0.6
Other (income) expense	(0.2)	1.1	(0.1)	(4.7)
Pension plan annuitization (note 2)	0.5	—	17.7	—
Termination of fibre supply agreement (note 3)	—	15.0	—	15.0
	24.9	41.5	91.7	85.2
Loss before income taxes	(13.6)	(27.5)	(22.5)	(36.1)
Income tax recovery (note 4)	(0.8)	(10.5)	(24.8)	(10.0)
Net earnings (loss)	\$ (12.8)	\$ (17.0)	\$ 2.3	\$ (26.1)
Earnings (loss) per common share (note 5)				
Basic	\$ (0.17)	\$ (0.22)	\$ 0.03	\$ (0.34)
Diluted	\$ (0.16)	\$ (0.22)	\$ 0.03	\$ (0.34)

Consolidated Statements of Retained Earnings

(in millions of dollars)
Unaudited

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Retained earnings, beginning of period	\$ 48.3	\$ 19.3	\$ 33.2	\$ 28.4
Net earnings (loss) for the period	(12.8)	(17.0)	2.3	(26.1)
Retained earnings, end of period	\$ 35.5	\$ 2.3	\$ 35.5	\$ 2.3

See accompanying notes to unaudited interim consolidated financial statements.

TIMBERWEST FOREST CORP.

Consolidated Balance Sheets

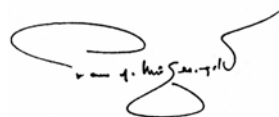
(in millions of dollars)

	As at September 30, 2006 <i>Unaudited</i>	As at December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 10.3	\$ 3.0
Accounts receivable	13.1	23.9
Inventories	42.4	48.2
Prepaid expenses and other current assets	8.7	11.2
Future income taxes	2.2	2.5
	76.7	88.8
Property, plant and equipment, net (note 6)	1,300.6	1,318.4
Other assets (note 7)	2.7	11.9
	\$ 1,380.0	\$ 1,419.1
Liabilities and Unitholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 39.2	\$ 30.1
Distribution payable	20.9	20.9
	60.1	51.0
Revolving credit facilities (note 8)	—	37.0
Debentures	195.0	195.0
Long-term silviculture liability	3.7	3.2
Employee future benefits (note 9)	38.5	28.6
Future income taxes	159.6	184.9
	456.9	499.7
Series A Subordinate Notes owned by unitholders (note 10)	696.6	695.7
	1,153.5	1,195.4
Unitholders' equity:		
Share capital, consisting of common and preferred shares (note 10)	190.1	189.8
Contributed surplus	0.9	0.7
Retained earnings	35.5	33.2
	226.5	223.7
	\$ 1,380.0	\$ 1,419.1

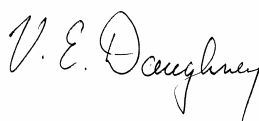
Subsequent event (note 12)

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	
	2006	2005	2006	2005
Cash provided by (used in):				
Operating activities:				
Net earnings (loss)	\$ (12.8)	\$ (17.0)	\$ 2.3	\$ (26.1)
Items not involving cash:				
Depreciation, depletion and amortization	2.1	2.5	6.8	7.2
(Gain) loss on sale of property, plant and equipment	(1.3)	0.1	(4.0)	(6.2)
Future income tax recovery	(0.8)	(10.7)	(25.0)	(10.6)
Other non-cash items	1.6	1.0	18.2	1.8
	(11.2)	(24.1)	(1.7)	(33.9)
Changes in non-cash working capital:				
Accounts receivable	8.5	7.0	10.8	(6.5)
Inventories	6.1	0.7	5.8	(7.7)
Prepaid expenses and other	0.9	(5.2)	2.5	(7.9)
Accounts payable and accrued liabilities	(5.1)	4.0	9.2	10.9
Distribution payable	—	—	—	0.1
	(0.8)	(17.6)	26.6	(45.0)
Financing activities:				
Issuance of Stapled Units on exercise of options:				
Series A Subordinate Notes	0.5	0.2	0.9	3.4
Share capital	0.2	—	0.3	1.0
	0.7	0.2	1.2	4.4
Demand credit facility	—	0.5	—	0.5
Revolving credit facilities	—	13.2	(37.0)	27.5
	0.7	13.9	(35.8)	32.4
Investing activities:				
Proceeds from sale of property, plant and equipment	2.2	2.4	19.1	33.0
Additions to property, plant and equipment	(2.2)	(0.2)	(3.7)	(22.5)
Other assets	0.2	1.5	1.1	0.5
	0.2	3.7	16.5	11.0
Increase (decrease) in cash and cash equivalents	0.1	—	7.3	(1.6)
Cash and cash equivalents, beginning of period	10.2	—	3.0	1.6
Cash and cash equivalents, end of period	\$ 10.3	\$ —	\$ 10.3	\$ —
Supplemental information:				
Interest on Series A Subordinate Notes paid to unitholders	\$ 20.9	\$ 20.8	\$ 62.7	\$ 62.3
Other interest paid	\$ 0.1	\$ 0.8	\$ 7.5	\$ 8.6
Income taxes paid	\$ (0.1)	\$ 0.2	\$ 0.2	\$ 0.5

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, 2006 and 2005

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

1. Significant Accounting Policies

The accompanying unaudited interim consolidated financial statements include the accounts of TimberWest Forest Corp. and its subsidiaries (“the Company”), have been prepared in accordance with Canadian generally accepted accounting principles and are expressed in Canadian dollars. 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, 2005.

2. Pension Plan Annuitization

In the second quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for all retirees in the Company’s salaried employee defined benefit pension plans. Effective April 15, 2006, \$89.7 million of pension obligations were transferred to the financial institution at a cost to the Company of \$1.1 million. In addition, the Company recorded a \$17.2 million non-cash pension expense in the second quarter of 2006 related to this transaction, representing the unamortized net actuarial loss associated with retiree pension obligations at the transaction date that would have otherwise been amortized over the expected life of the pension plan (see notes 4 and 9).

In the third quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for members of one of the Company’s remaining small defined benefit pension plans. Effective July 14, 2006, approximately \$1.0 million of pension obligations and \$1.4 million of pension assets were transferred to the financial institution. As this pension plan was in a surplus position at the time of this transaction there was no cash cost to the Company, however, the Company recorded a \$0.5 million non-cash pension expense in the third quarter of 2006, representing the settlement loss on finalization of this transaction (see note 9).

3. Termination of Fibre Supply Agreement

In the third quarter of 2005, the Company reached an agreement to terminate a fibre supply agreement with a customer for payment of \$15.0 million. The fibre supply agreement was originally entered into in 1997 and required the Company to offer the customer, in perpetuity, an annual volume of 330,000 m³ of sawlogs at domestic market prices.

TIMBERWEST FOREST CORP.

Notes to Unaudited Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2006 and 2005

4. Income Taxes

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Current income tax expense				
Large corporation tax	\$ —	\$ 0.2	\$ 0.2	\$ 0.6
Future income tax expense (recovery)	(0.8)	(10.7)	(25.0)	(10.6)
	\$ (0.8)	\$ (10.5)	\$ (24.8)	\$ (10.0)

In the second quarter of 2006, a number of changes to Canadian federal income tax rates were substantively enacted, including: elimination of the Large Corporations Tax (LCT), effective January 1, 2006; elimination of the 4% surtax effective January 1, 2008; and the reduction of the federal general corporate income tax rate to 20.5% for 2008, 20% for 2009, and 19% for 2010 and subsequent years. These changes will result in a reduction in the combined federal and provincial statutory corporate income tax rate from its present rate of 34.12% to 32.5% for 2008, 32.0% for 2009, and 31.0% for 2010 and subsequent years. As a result of these future income tax rate reductions, the Company's future income tax liability was reduced by \$14.8 million and the Company's income tax provision for the nine months ended September 30, 2006, includes a future income tax recovery of \$14.8 million.

Prior to the elimination of the LCT, the Company had paid installments in the amount of \$0.2 million, and the Company expects a refund of the paid installments before the end of the year.

In the second quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for all retirees in the Company's salaried employee defined benefit pension plans (see note 9). As a result of this transaction, the Company's future income tax liability was reduced by \$5.8 million and the Company's income tax provision for the nine months ended September 30, 2006, includes a future income tax recovery of \$5.8 million.

5. Earnings per Share

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Net earnings (loss)	\$ (12.8)	\$ (17.0)	\$ 2.3	\$ (26.1)
Basic weighted average number of common shares	77,561,016	77,268,894	77,524,571	77,143,044
Incremental common shares from potential exercise of options	82,386	142,248	74,828	143,482
Diluted weighted average number of common shares	77,643,402	77,411,142	77,599,399	77,286,526
Basic net earnings (loss) per common share	\$ (0.17)	\$ (0.22)	\$ 0.03	\$ (0.34)
Diluted net earnings (loss) per common share	\$ (0.16)	\$ (0.22)	\$ 0.03	\$ (0.34)

6. Property, Plant and Equipment

Property, plant and equipment at September 30, 2006, includes private timberlands with a carrying value of \$1,221.9 million. This amount includes a valuation increase adjustment of \$389.8 million recorded in the year ended December 31, 2000 resulting from the adoption of Section 3465 – *Income Taxes* of the CICA Handbook, which was mandatory for fiscal years ending on or after January 1, 2000.

TIMBERWEST FOREST CORP.

Notes to Unaudited Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2006 and 2005

7. Other Assets

	As at September 30, 2006	As at December 31, 2005
Deferred debt issue costs	\$ 1.0	\$ 1.4
Receivable on sale of property, plant and equipment	0.5	0.5
Other	1.2	1.7
Prepaid pension benefits (note 9)	—	8.3
	\$ 2.7	\$ 11.9

8. Revolving Credit Facilities

As at September 30, 2006, the Company had no borrowings on available credit facilities and had commitments of \$16.9 million relating to outstanding letters of credit, including \$16.3 million issued under its demand bank guarantee facility and \$0.6 million issued under its \$100.0 million long-term unsecured revolving facility.

9. Employee Future Benefits

	As at September 30, 2006	As at December 31, 2005
Pension benefits	\$ 8.3	\$ —
Non-pension post-retirement benefits	30.2	28.6
	\$ 38.5	\$ 28.6

The Company, through its subsidiaries, maintains pension plans that include defined benefit and defined contribution segments available to all salaried employees and to hourly employees not covered by union pension plans.

As at December 31, 2005, the Company had a prepaid pension asset of \$8.3 million. In April 2006, the Company recorded a \$17.2 million non-cash unamortized actuarial loss on the purchase of annuities for all retirees in the Company's salaried defined benefit pension plans. The reduction in the total pension asset on annuitization has resulted in a pension benefit obligation of \$8.3 million.

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

	As at September 30, 2006	As at December 31, 2005
Fair value of plan assets	\$ 6.2	\$ 97.4
Accrued benefit obligation	17.5	106.4
Excess of accrued benefit obligation over plan assets	(11.3)	(9.0)
Unamortized net actuarial loss	3.0	17.3
Net asset (accrued liability)	\$ (8.3)	\$ 8.3

For the three months ended September 30, 2006, the Company recorded an expense of \$1.1 million for pension benefit costs (2005 – \$0.6 million), including a \$0.5 million non-cash cost related to the annuitization transaction completed in the third quarter (see note 2), and made cash payments of \$0.4 million to fund current and future service costs (2005 – \$0.8 million). For the nine months ended

TIMBERWEST FOREST CORP.

Notes to Unaudited Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2006 and 2005

9. Employee Future Benefits (continued)

September 30, 2006, the Company recorded an expense of \$19.3 million for pension benefit costs (2005 – \$1.7 million), including a \$17.7 million non-cash cost related to the annuitization transactions completed in the second and third quarters (see note 2), and made cash payments of \$3.1 million to fund current and future service costs (2005 – \$2.6 million), including \$1.1 million related to the annuitization transaction completed in the second quarter.

The Company also provides non-pension benefits consisting of group life insurance and medical benefits to eligible retired employees, which the Company funds on an as-incurred basis. For the three months ended September 30, 2006, the Company recorded an expense of \$1.0 million for non-pension benefit costs (2005 – \$0.9 million) and made cash payments of \$0.4 million to fund current benefit costs (2005 – \$0.3 million). For the nine months ended September 30, 2006, the Company recorded an expense of \$3.0 million for non-pension benefit costs (2005 – \$2.7 million) and made cash payments of \$1.4 million to fund current benefit costs (2005 – \$1.4 million).

10. Stapled Units

	Number	Stapled Unit Components		Total
		Series A Subordinate Notes	Share Capital (consisting of common and preferred shares)	
Nine months ended September 30, 2005:				
Balance, December 31, 2004	76,907,017	\$ 690.5	\$ 187.8	\$ 878.3
Issuance of Stapled Units on exercise of options	368,064	3.4	1.0	4.4
Balance, September 30, 2005	77,275,081	\$ 693.9	\$ 188.8	\$ 882.7
Nine months ended September 30, 2006:				
Balance, December 31, 2005	77,487,571	\$ 695.7	\$ 189.8	\$ 885.5
Issuance of Stapled Units on exercise of options	95,517	0.9	0.3	1.2
Balance, September 30, 2006	77,583,088	\$ 696.6	\$ 190.1	\$ 886.7

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

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

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

TIMBERWEST FOREST CORP.

Notes to Unaudited Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2006 and 2005

11. 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 three months ended September 30, 2006, no Stapled Unit options were granted (2005 – nil). In the nine months ended September 30, 2006, 245,238 Stapled Unit options were granted at an average exercise price of \$13.94 (2005 – 348,998 Stapled Unit options were granted at an average exercise price of \$15.79).

The Company has applied the fair value method of accounting for Stapled Unit option grants awarded on or after January 1, 2003 in order to determine the compensation cost to the Company. The fair value of each option granted was estimated on the date of grant using the Black-Scholes option pricing model using the following weighted average assumptions:

	2005	2006
Risk-free interest rate	4.1%	3.5%
Expected life (years)	5.0	5.0
Expected volatility	20.3%	20.0%
Dividend yield	8.0%	6.8%
Number of options granted	245,238	348,998
Fair value of each option granted	\$0.92	\$1.30

The compensation cost for the 245,238 Stapled Unit options granted between January 1, 2006 and September 30, 2006 is \$226,000 (2005 – 348,998 Stapled Unit options were granted with a compensation cost of \$454,900). The compensation cost of Stapled Unit option awards is amortized against earnings over the three-year vesting period of the underlying options and an expense of \$73,000 and \$216,000 has been recognized in net earnings for the three and nine month periods ended September 30, 2006, respectively, (2005 – \$111,000 and \$280,000, respectively,) for option awards made in fiscal 2003 through 2006, with a corresponding credit to contributed surplus.

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 September 30, 2006, \$0.3 million has been accrued for awards granted under this plan (2005 – \$0.3 million) and \$0.2 million has been amortized against earnings for the quarter (2005 – \$0.4 million). For the nine months ended September 30, 2006, \$0.8 million has been accrued for awards granted under this plan (2005 – \$0.9 million) and \$0.7 million has been amortized against earnings for this period (2005 – \$0.8 million).

In the three months ended September 30, 2006, a total of 53,425 Stapled Unit options with an average exercise price of \$12.75 were exercised and 5,637 Stapled Unit options with an average exercise price of \$15.80 were cancelled (2005 – 10,218 Stapled Unit options with an average exercise price of \$12.72 were exercised and 18,724 Stapled Unit options with an average exercise price of \$14.56 were cancelled). In the nine months ended September 30, 2006, a total of 95,517 Stapled Unit options with an average exercise price of \$12.59 were exercised and 5,637 Stapled Unit options with an average exercise price of \$15.80 were cancelled (2005 – 368,064 Stapled Unit options with an average exercise price of \$11.84 were exercised and 70,543 Stapled Unit options with an average exercise price of \$14.33 were cancelled).



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Notes to Unaudited Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2006 and 2005

12. Subsequent Event

Effective October 12, 2006, the governments of Canada and the United States have agreed to terms to resolve the softwood lumber dispute under the Softwood Lumber Agreement. On October 19, 2006, the United States Department of Commerce revoked all existing anti-dumping and countervailing duty orders on softwood lumber shipped to the United States from Canada and ordered the liquidation of the duties collected from May 22, 2002 with interest. By agreement, U.S. \$1 billion will be retained by the U.S. Government for distribution to certain U.S. interests and the remaining duty deposits will be refunded to Canadian interests. The Softwood Lumber Agreement requires that an export tax be collected by the government of Canada, which is based upon the price and volume of lumber shipped. Canada implemented the export tax on October 12, 2006, however, the export tax legislation requires approval by the Parliament of Canada before becoming law.

The Company anticipates receiving approximately \$3.2 million in refunded duties and interest, which is expected to be received in late 2006 or 2007.

13. Comparative Figures

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

TIMBERWEST FOREST CORP.

Supplemental Information

Unaudited

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Sales by Product (in millions of dollars)				
Log sales				
Domestic	\$ 26.4	\$ 37.0	\$ 96.2	\$ 106.4
Export – Asia	23.0	27.4	102.1	83.9
Export – US	12.2	22.0	43.0	48.8
Total log sales	61.6	86.4	241.3	239.1
Lumber	27.6	22.9	89.5	64.1
Wood chips and other	5.8	7.5	17.4	17.3
Real estate	2.3	2.4	21.0	4.9
	\$ 97.3	\$ 119.2	\$ 369.2	\$ 325.4
Sales Volume				
Logs (thousand m ³)				
Domestic	330.9	537.8	1,228.2	1,461.2
Export – Asia	177.9	203.6	775.3	618.5
Export – US	107.4	246.9	439.5	544.9
	616.2	988.3	2,443.0	2,624.6
Lumber (million fbm)	41.8	42.9	140.3	119.0
Log Sales Mix (thousand m³)				
Fir	320.5	507.4	1,585.0	1,491.0
Hembal	186.9	321.3	441.4	687.6
Cedar	61.2	92.4	221.8	264.6
Other	47.6	67.2	194.8	181.4
	616.2	988.3	2,443.0	2,624.6
Production Volume				
Logs (thousand m ³)				
Public tenures	214.1	277.1	634.9	585.9
Private timberlands	378.5	773.4	1,981.6	2,254.5
	592.6	1,050.5	2,616.5	2,840.4
Lumber (million fbm)	45.8	47.4	141.9	123.5
Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)* (in millions of dollars)				
Net earnings (loss)	\$ (12.8)	\$ (17.0)	\$ 2.3	\$ (26.1)
Add (deduct):				
Interest on Series A Subordinate Notes paid to unitholders	20.9	20.8	62.7	62.4
Interest on long-term debt	3.6	4.3	11.0	10.8
Interest on short-term debt	–	0.1	–	1.1
Income tax recovery	(0.8)	(10.5)	(24.8)	(10.0)
Depreciation, depletion and amortization	2.0	2.3	6.4	6.6
Amortization of deferred financing costs	0.1	0.2	0.4	0.6
EBITDA	\$ 13.0	\$ 0.2	\$ 58.0	\$ 45.4

* 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. Management believes that the presentation of this measure will enhance an investor's understanding of the Company's operating performance.

TIMBERWEST FOREST CORP.

About TimberWest

TimberWest Forest Corp. is uniquely positioned as the largest owner of private forest lands in western Canada. The Company owns in fee simple approximately 334,000 hectares or 825,000 acres of private timberland that, over the previous five years, have provided an annual average harvest of 2.594 million m³ of logs and have an approximate annual growth rate of 8.0 m³ per hectare per year on the productive land base. These timberlands are located on Vancouver Island and the majority of the land base supports the growth of Douglas fir, a premium tree species sought after for structural purposes. TimberWest runs fully-contracted harvesting operations. With approximately 70% of the Company's logging now being done in second-growth stands, TimberWest leads the industry in the growing and harvesting of second-growth timber.

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

TimberWest also owns renewable Crown harvest rights to 0.7 million m³ of logs per year and operates a sawmill located near Campbell River, BC.

In addition, approximately 38,000 hectares or 94,000 acres of the Company's private forest lands have been identified as having greater value as real estate properties and will progressively be made available for higher uses over the next ten to fifteen years. The Company reviews its land base on a periodic basis to update the size of its portfolio of higher use properties.

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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

