



**4<sup>th</sup> Quarter**  
INTERIM REPORT

For the three & 12 months  
ended December 31, 2004

maintaining our  
**FOCUS**

GROWING GREATEST VALUE THROUGH OPERATIONS EXCELLENCE



# TIMBERWEST FOREST CORP.

## To Our Unitholders,

2004 was a milestone year for TimberWest; we not only delivered very strong financial results and achieved many of the Operations Excellence goals established three years ago, we also transformed our business into a more focused forest land management company.

This performance was possible because everyone pulled together to focus on our Operations Excellence strategy, even when it meant significant changes for the people involved. I want to thank all of our employees for their hard work and dedication.

The Company generated distributable cash of \$125.2 million, or \$1.64 per Stapled Unit for the year ended December 31, 2004, compared to \$51.4 million, or \$0.67 per unit in 2003. Year-over-year, we more than doubled distributable cash as a result of better operating performance combined with net one-time gains. In 2004 we improved operating margins from timberland operations, realized higher sales and operating earnings from our sawmill and returned to lower capital expenditure levels. Distributable cash generated in 2004 also includes \$16.7 million in net cash proceeds from the sale of Tree Farm Licence 46 (TFL 46) and \$14.0 million in cash proceeds from the settlement of the 1995 expropriation of harvesting rights in the Walbran Valley. These proceeds were partially offset by business transformation restructuring charges of \$4.6 million.

For the quarter, TimberWest generated distributable cash of \$18.1 million, or \$0.24 per unit, compared to \$9.0 million in the fourth quarter of 2003, or \$0.12 per unit. The Company harvested its long-run sustainable yield in 2004 on a timely basis to maximize returns, with the outcome being a very strong performance for timberland operations. In fact, all private land operations were fully curtailed by early December as they had achieved their annual harvest plan. We also took some maintenance downtime at the Elk Falls Lumbermill during the last month of the year. The log sales volume was lower in the fourth quarter due to weakening demand for hemlock and cedar logs in the BC market caused by reduced demand for hemlock lumber in Japan and cedar lumber in the US. However, average log sales realizations for the quarter were higher than those achieved in the third quarter of 2004 and significantly improved over those achieved in the fourth quarter of 2003.

We concluded several real estate transactions in the quarter, generating proceeds of \$7.3 million, which brought the total sales proceeds to \$10.5 million for 2004. In addition, sales of equipment and other assets related to the business transformation generated \$3.1 million.

Turning back to 2004 as a whole and setting aside the one-time items, TimberWest generated its highest level of distributable cash since inception. And we accomplished this despite the rapid rise in value of the Canadian dollar relative to the US dollar.

Timberland operations remained focused on cost savings programs throughout the year, which continued to generate significant benefits in 2004. We achieved overall cost reductions averaging \$6.80/m<sup>3</sup> compared to 2003, bringing the three year cost-reduction program for the period 2002 through 2004 to a total improvement of \$11.57/m<sup>3</sup>, a reduction of 15 percent.

The Elk Falls Lumbermill continues to be cash and earnings positive even after being assessed international prices for the logs it consumes. Improved spreads were obtained through higher realizations, increased wood chip pricing and improved recoveries. Production increases were largely attributed to recent capital improvements and our preventative maintenance program. We are pleased with the progress Elk Falls continues to make in its ongoing efforts to achieve an economic return on the capital employed at the sawmill.

Safety was the one area where we unfortunately did not meet our goals this year. The timberland operations' 2004 MIR was 5.57, compared to a target MIR of 2.55. With a new collective agreement, it was a year of change and unusual circumstances for all of BC's coastal forest industry. For TimberWest employees, the change was even more extreme, as the Company sold TFL 46 and announced the intent to contract out timberland operations. While Elk Falls Lumbermill also slightly missed its target, the mill did achieve the lowest severity rating of reporting sawmills on the BC Coast.

The highlight of the year was our success in transforming our business into a more focused forest land management company as a result of the new labour agreement announced in May 2004. TimberWest moved quickly to competitively bid the road building and timber harvesting activities that were still being done by Company crews, to stump-to-dump contractors. We are the first major forest company on the BC coast to contract all of its harvesting and road building operations. This was a natural progression of our Operations Excellence strategy. It aligns our business model with industry norms in the rest of North America, further reduces costs and improves our flexibility to respond to market changes. Moreover, the necessary safeguards are in place with our contractual arrangements to ensure that new contractors operate to TimberWest standards of performance when it comes to issues of safety, the environment and log quality and merchandizing.

.....

## TIMBERWEST FOREST CORP.

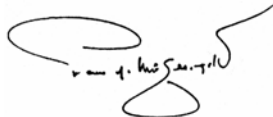
This followed the sale of the public land portion of our Southern Vancouver Island operation, TFL 46, to the Teal-Jones Group, allowing TimberWest to pursue the strategic objective of increasing our focus on the private timberland portion of our business.

We believe this sale and our move to a fully contracted out model are positive for all stakeholders. The sale contributes to the diversification of tenure that the government's new forest policy promotes, while enabling Teal-Jones, a privately-owned BC company, to secure fibre for its recently expanded BC sawmill business. Contracting out also provides opportunities for smaller, community-based businesses, which is something we committed to providing in the coastal "Vision" document developed by TimberWest, Interfor and Weyerhaeuser last year.

Another important Operations Excellence goal is to increase the sustainable yield of our annual timber harvest. We have focused on making our trees more valuable by increasing genetic worth, fertilization and managing competing vegetation. We have also cruised more of our timberlands and enhanced our forest inventory management information system to refine calculations on inventory volumes, better predict growth rates and better understand the outcomes of activities undertaken to improve growth and yield. As a result of all the work in this area over the past three years, we were very pleased to announce an increase in the long-run sustainable yield on our private timberlands in 2004, from 2.3 million m<sup>3</sup> to 2.5 million m<sup>3</sup>. The computation of the Company's recently revised long-run sustainable yield will be validated by the Company's external SFI® auditor, KPMG Performance Registrar Inc., in the first half of 2005.

I thank all TimberWest employees and contractors for working so hard yet again in 2004. I also thank our customers and suppliers.

On behalf of the Board of Directors



Paul J. McElligott  
President and Chief Executive Officer

Vancouver, British Columbia  
February 8, 2005

# TIMBERWEST FOREST CORP.

## Management's Discussion and Analysis

### For the three and twelve months ended December 31, 2004 and 2003

Management's discussion and analysis supplements, but does not form part of, the unaudited interim consolidated financial statements of TimberWest Forest Corp. ("TimberWest" or "the Company") and the notes thereto for the fourth quarter of 2004. This discussion and analysis provides an overview of significant developments that have affected TimberWest's performance during the fourth quarter and year to date of 2004 relative to the fourth quarter and year to date of 2003, and that have affected the Company's financial position as at December 31, 2004, relative to December 31, 2003. Factors that could affect future operations are also discussed. These factors may be affected by known and unknown risks and uncertainties that may cause the actual future results of the Company to be materially different than those expressed or implied in this discussion. These risks and uncertainties are described herein and in the management's discussion and analysis contained in the Company's 2003 Annual Report.

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, 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 February 8, 2005.

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

### Distributable Cash

(in millions of dollars)	Three months ended December 31		Twelve months ended December 31	
	2004	2003	2004	2003
Net earnings (loss)	\$ 12.2	\$ (0.7)	\$ 76.9	\$ 24.8
Income tax benefit related to distributions	7.3	1.5	29.3	17.4
Earnings available for distribution	19.5	0.8	106.2	42.2
Future income tax expense (recovery) on earnings before extraordinary item	(6.3)	0.5	(12.4)	—
Future income tax expense on extraordinary item	—	—	5.0	—
Earnings available for distribution before provision for future income taxes	13.2	1.3	98.8	42.2
Add (deduct):				
Depreciation, depletion and amortization	2.6	2.8	11.2	11.2
Proceeds from sale of property, plant and equipment	12.0	4.5	33.3	11.4
Gain on sale of property, plant and equipment	(6.5)	(0.9)	(12.4)	(3.7)
Additions to property, plant and equipment	(4.0)	(1.0)	(8.5)	(18.0)
Other non-cash items	0.8	2.3	2.8	8.3
	4.9	7.7	26.4	9.2
Distributable cash	\$ 18.1	\$ 9.0	\$ 125.2	\$ 51.4
Consists of:				
Distributable cash before extraordinary item	\$ 18.1	\$ 9.0	\$ 111.2	\$ 51.4
Distributable cash from extraordinary item	—	—	14.0	—
	\$ 18.1	\$ 9.0	\$ 125.2	\$ 51.4

# TIMBERWEST FOREST CORP.

Per Stapled Unit amounts:

<i>(in dollars)</i>	Three months ended December 31		Twelve months ended December 31	
	2004	2003	2004	2003
<i>Basic and diluted earnings available for distribution before provision for future income taxes per weighted average Stapled Unit</i>	\$ 0.17	\$ 0.02	\$ 1.29	\$ 0.55
<i>Basic and diluted distributable cash per weighted average Stapled Unit:</i>				
– before extraordinary item	\$ 0.24	\$ 0.12	\$ 1.45	\$ 0.67
– from extraordinary item	–	–	0.19	–
	\$ 0.24	\$ 0.12	\$ 1.64	\$ 0.67
<i>Cash distributions paid per Stapled Unit</i>	\$ 0.27	\$ 0.27	\$ 1.08	\$ 1.08

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

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

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

	2004	2003	2002	2001	2000	1999	1998
<b>Distributable Cash</b> <i>(in millions of dollars)</i>							
First	\$ 27.7	\$ 25.7	\$ 21.2	\$ 25.9	\$ 28.4	\$ 24.5	\$ 13.2
Second	43.5	4.7	10.6	26.7	28.2	25.1	24.0
Third	35.9	12.0	34.1	14.1	14.1	14.0	11.5
Fourth	18.1	9.0	24.2	16.8	18.5	19.7	19.6
	\$ 125.2	\$ 51.4	\$ 90.1	\$ 83.5	\$ 89.2	\$ 83.3	\$ 68.3
<b>Distributable Cash per Stapled Unit</b> <i>(in dollars)</i>							
First	\$ 0.36	\$ 0.34	\$ 0.30	\$ 0.40	\$ 0.41	\$ 0.36	\$ 0.19
Second	0.57	0.06	0.14	0.41	0.42	0.36	0.34
Third	0.47	0.15	0.45	0.22	0.22	0.20	0.17
Fourth	0.24	0.12	0.32	0.26	0.29	0.28	0.28
	\$ 1.64	\$ 0.67	\$ 1.21	\$ 1.29	\$ 1.34	\$ 1.20	\$ 0.98

## Quarterly Financial Highlights

TimberWest generated distributable cash of \$18.1 million or basic and diluted distributable cash of \$0.24 per weighted average Stapled Unit for the quarter ended December 31, 2004, compared to distributable cash of \$9.0 million or basic and diluted distributable cash of \$0.12 per weighted average Stapled Unit for the same period in 2003. The increase in distributable cash from the prior year can be attributed to higher operating earnings in the fourth quarter of 2004, reflecting higher sales due to higher average realizations on log sales, a higher volume of lumber sales and an increase in real estate sales compared to the same period in the prior year. Earnings available for distribution for the fourth quarter of 2004, before provision for future income taxes, were \$13.2 million or \$0.17 per basic and diluted weighted average Stapled Unit compared to \$1.3 million or \$0.02 per basic and

# TIMBERWEST FOREST CORP.

diluted weighted average Stapled Unit for the same quarter in 2003. Sales for the fourth quarter of 2004 were \$114.9 million compared to sales of \$96.3 million reported for the fourth quarter of 2003. Operating earnings were \$15.0 million for the fourth quarter of 2004 compared to \$5.8 million for the same period in 2003, representing a 116% improvement in the operating margin year over year, primarily reflecting higher real estate sales in 2004 and the higher margins on those sales. Earnings before interest, taxes, depreciation and amortization (EBITDA)<sup>1</sup> for the quarter ended December 31, 2004, were \$20.1 million or \$0.26 per basic and diluted weighted average Stapled Unit compared to \$8.7 million or \$0.11 per basic and diluted weighted average Stapled Unit for the same period in 2003. Net earnings for the quarter ended December 31, 2004, were \$12.2 million, equating to a basic and diluted net loss of \$0.02 per weighted average common share, compared to a net loss of \$0.7 million or a basic and diluted net loss of \$0.26 per weighted average common share for the same period in 2003.

## Year to Date Financial Highlights

TimberWest generated distributable cash of \$125.2 million or basic and diluted distributable cash of \$1.64 per weighted average Stapled Unit for the year ended December 31, 2004, compared to distributable cash of \$51.4 million or basic and diluted distributable cash of \$0.67 per weighted average Stapled Unit for 2003. This increase can be attributed to several factors, including: higher operating earnings in 2004, reflecting higher average realizations on log and lumber sales and improvements in production costs over 2003; increased proceeds from the sale of other property, plant and equipment, including \$16.7 million in cash proceeds from the sale of Tree Farm Licence 46 (TFL 46) in the second quarter of 2004; capital expenditures in 2004 that were \$9.5 million lower relative to 2003; and the receipt of \$14.0 million or \$0.18 per Stapled Unit as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley. Earnings available for distribution for 2004, before provision for future income taxes, were \$98.8 million or \$1.29 per basic and diluted weighted average Stapled Unit compared to \$42.2 million or \$0.55 per basic and diluted weighted average Stapled Unit for 2003. Sales for 2004 were \$477.0 million compared to sales of \$445.4 million reported for 2003. Operating earnings were \$94.4 million for 2004 compared to \$58.7 million for 2003, representing a 50% margin improvement compared to 2003. EBITDA for 2004, before the expropriation settlement proceeds which have been accounted for as an extraordinary item, were \$112.7 million or \$1.47 per basic and diluted weighted average Stapled Unit compared to \$70.3 million or \$0.92 per basic and diluted weighted average Stapled Unit for 2003. Earnings before the extraordinary item 2004 were \$67.9 million or basic and diluted earnings before extraordinary item of \$0.19 per weighted average common share, compared to earnings of \$24.8 million or a basic and diluted loss of \$0.52 per weighted average common share for 2003. Net earnings for 2004 were \$76.9 million or basic and diluted net earnings of \$0.31 per weighted average common share, compared to net earnings of \$24.8 million or a basic and diluted net loss of \$0.52 per weighted average common share for 2003.

On September 24, 2004, the Company received \$14.0 million from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley and Hitchie Creek areas for park creation purposes under the *Park Amendment Act, 1995* (British Columbia). The \$14.0 million proceeds have been accounted for as an extraordinary item in the consolidated statements of earnings, net of \$5.0 million in income taxes effected at statutory tax rates. There will be no cash taxes payable on this settlement. Additional information on this settlement is provided under "Highlights and Significant Transactions – *Extraordinary Item – Expropriation Settlement Proceeds*" in this management's discussion and analysis.

On June 24, 2004, the Company announced a plan to transform its business operations to focus on forest land management through a restructuring of the Company's log harvesting operations and a move to contract out all logging activities. Operating results for the three and twelve month periods ended December 31, 2004 include an expense of \$1.9 million and \$4.6 million, respectively, for costs relating to this restructuring. Additional information on this plan is provided under "Highlights and Significant Transactions – *Business Transformation*" in this management's discussion and analysis.

Early in the first quarter of 2004, the Company signed a definitive agreement for the sale of the public land portion of its southern Vancouver Island operations, referred to as Tree Farm Licence 46 (TFL 46). The Company completed the sale of TFL 46 on May 6, 2004, at a sale price of \$17.9 million. Additional information on this transaction is provided under "Highlights and Significant Transactions – *Sale of Tree Farm Licence 46*" in this management's discussion and analysis.

<sup>1</sup> 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 as determined in accordance with GAAP and EBITDA is provided in the supplemental information appended to this interim report.



## TIMBERWEST FOREST CORP.

During the second quarter of 2004, the Company completed and received a renewal of short-term financing from a Canadian bank in the form of an unsecured 364-day committed revolving facility in the amount of \$40.0 million due on May 25, 2005.

During the first quarter of 2004, the Company completed and received a renewal of short-term financing from a Canadian bank consisting of an unsecured demand bank guarantee facility in the amount of \$16.0 million and an unsecured 364-day committed revolving facility in the amount of \$40.0 million, both due on March 1, 2005.

### Highlights and Significant Transactions

#### *Business Transformation:*

On June 24, 2004, the Company announced a plan to transform its business model through a restructuring of the Company's log harvesting operations and a move to contract out all logging activities. Historically, 50% of the Company's log harvesting was performed by contractors. Under the transformation plan, the Company has contracted out the remainder of its logging activities to unionized contractors on a competitive-bid basis, effective January 1, 2005.

The Company's timberland operations employees were affected by this change. The Company's former 430 hourly employees continue to be represented by the the United Steelworkers of America (formerly Industrial, Wood & Allied Workers of Canada), and many were hired by contractors who recognize the seniority these employees had with the Company. Roles and responsibilities of certain salaried employees have also changed, and some 20 salaried positions were eliminated. Certain facilities were also closed. Operating earnings for the three and twelve month periods ended December 31, 2004, include an expense of \$1.9 million and \$4.6 million, respectively, for costs relating to this restructuring.

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

#### *Sale of Tree Farm Licence 46:*

On May 6, 2004, the Company completed the sale of its southern Vancouver Island public land operations, referred to as TFL 46, for a sale price of \$17.9 million. TFL 46 represented part of the Company's public land logging business, including timber rights to an annual allowable cut of approximately 500,000 m<sup>3</sup> on 76,574 hectares of Crown land, and had been operated by TimberWest as part of its Honeymoon Bay operation on southwest Vancouver Island.

Under the terms of the sale, \$0.4 million of silviculture liabilities were assumed by the purchaser and leased equipment with a value of \$6.0 million was transferred to the purchaser, relieving the Company of commitments for future payments under operating leases in the amount of \$2.6 million. In addition, this transaction resulted in a reduction in the Company's working capital by approximately \$8.0 million. Further, some 113 hourly and seven salaried employees associated with this operation were transferred to the purchaser.

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. The completion of this transaction allows the Company to pursue its strategic objective of focusing on its private timberland business.

#### *Increase in Long-run Sustainable Yield:*

On October 19, 2004, the Company announced an increase in the long-run sustainable yield on its private timberlands, from 2.3 million m<sup>3</sup> to 2.5 million m<sup>3</sup> on the basis of improvements in the underlying growth rates of the forest inventory due to yield increases from a range of silviculture practices. The computation of the Company's revised long-run sustainable yield will be audited by the Company's external SFI<sup>®</sup> auditor, KPMG Performance Registrar Inc., in the first half of 2005.

# TIMBERWEST FOREST CORP.

## *Extraordinary Item – Expropriation Settlement Proceeds:*

On September 24, 2004, the Company received \$14.0 million from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley and Hitchie Creek areas for park creation purposes under the *Park Amendment Act, 1995* (British Columbia). The \$14.0 million proceeds from this settlement have been accounted for as an extraordinary item, net of \$5.0 million in income taxes effected at statutory tax rates, in the consolidated statements of earnings for the year ended December 31, 2004. As the Company has non-capital losses carried forward from previous taxation years, there will be no cash income taxes payable on the proceeds from this settlement. The future income tax expense on earnings before the extraordinary item for the year ended December 31, 2004, has been reduced by \$5.0 million to recognize the benefit of the losses utilized and fully offsets the tax expense charged to the extraordinary item.

## *Pension Valuation:*

The triennial actuarial valuation of the Company's pension obligations for funding purposes, as at December 31, 2003, was completed during the first quarter of 2004. This valuation identified a going-concern deficit of \$3.9 million and a solvency deficit of \$5.1 million for the Company's defined benefit pension plans. Based on the results of the valuation, commencing in 2004, the Company is required to fund annual current service costs of approximately \$1.4 million, including required contributions under both the defined benefit plans and the defined contribution plan. In addition, the Company is required to fund the deficit position in the defined benefit plans with annual costs of approximately \$1.2 million. The cash contribution related to pension expense deducted from distributable cash for fiscal 2004 was \$2.8 million.

## **Cash Distribution**

On February 8, 2005, TimberWest announced a distribution of \$0.269 per Stapled Unit, payable April 15, 2005, to unitholders of record on April 1, 2005. From inception to December 31, 2004, the Company has generated distributable cash of \$596.8 million while, including the January 15, 2005 distribution of \$20.7 million, the Company has paid out \$566.8 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 December 31, 2004, were \$73.8 million, up 6% from log sales of \$69.8 million for the quarter ended December 31, 2003. This increase reflects the net effect of a 14% increase in overall log sales realizations, averaging \$104 per m<sup>3</sup> for the fourth quarter of 2004, up from the \$91 per m<sup>3</sup> for the comparative period in 2003, and a 7% decrease in the volume of logs sold, with 710.4 thousand m<sup>3</sup> sold in the fourth quarter of 2004 compared with 766.6 thousand m<sup>3</sup> sold in the comparative period of 2003. The increase in average log sales realizations can be attributed to the net effect of a 20% increase in the volume of logs sold into higher-margin export markets, offset by a 19% decrease in the volume of lower-margin domestic log sales, as well as a stronger sales mix in the current year period. Log sales to domestic market customers were \$38.1 million, down 7% from the comparative quarter in 2003, reflecting the drop in domestic log sales volume to 432.9 thousand m<sup>3</sup> from 534.4 thousand m<sup>3</sup> in 2003, offset in part by a 15% increase in realizations to \$88 per m<sup>3</sup> from \$77 per m<sup>3</sup> in 2003. Export sales for the fourth quarter of 2004 were \$35.7 million, up 24% over the comparative period in 2003, reflecting the 20% increase in export sales volume to 277.5 thousand m<sup>3</sup>, and a 4% increase in average realizations to \$129 per m<sup>3</sup>. Improved realizations for the fourth quarter also reflect an increase in the proportion of higher-value fir in the sales mix compared to the same period in 2003, as well as stronger pricing compared to the prior year period.

The operating margin from timberland operations for the fourth quarter of 2004 averaged 24% of log sales, compared to 13% of log sales for the fourth quarter of 2003. The improved results for 2004 primarily reflect the improved realizations discussed previously, offset in part by an increase in production costs for the fourth quarter of 2004, to \$72 per m<sup>3</sup>, compared to \$71 per m<sup>3</sup> for the comparative period in 2003, primarily due to higher stumpage, road building, towing and sorting costs in the current year.

Log sales for the year ended December 31, 2004 were \$337.6 million, down 1% from log sales of \$340.1 million for 2003. This decrease is the net result of a 4% decrease in the volume of logs sold in 2004 compared to 2003, and a 4% increase in overall log sales realizations compared to 2003. Sales to domestic market customers of \$181.6 million were up 2% over 2003, reflecting a 1% increase in log sales volume to 2,099.9 thousand m<sup>3</sup>, and a 1% increase in average sales realizations, to \$86 per m<sup>3</sup> for 2004. Export sales of \$156.0 million for 2004 were

# TIMBERWEST FOREST CORP.

down 4% compared to 2003, reflecting a 12% decrease in log sales volume to 1,152.2 thousand m<sup>3</sup>, offset by a 9% increase in average realizations to \$135 per m<sup>3</sup>. Currency remained a factor for export sales in 2004, as the Canadian dollar strengthened by approximately 8% compared to its US counterpart relative to 2003. During the last half of 2004 very little of the exchange rate effect was passed through to export markets in the form of higher US dollar prices.

The timberland operations' operating margin for 2004 averaged 32% of log sales, compared to 23% of log sales for 2003. A focus on cost reduction throughout the year contributed to a 9% decrease in logging production costs for 2004, down to \$66 per m<sup>3</sup> compared to \$73 per m<sup>3</sup> for 2003. These results reflect the effect of lower yarding, transportation and road building costs compared to 2003. Private timberland annual harvest levels were reached in early December 2004, allowing the Company to fully curtail these operations and focus on the transition to contracting out these operations effective the beginning of 2005.

Lumber sales for the quarter ended December 31, 2004 of \$28.5 million were 51% greater than sales of \$18.9 million for the quarter ended December 31, 2003. This improvement reflects strong market demand and a 67% increase in the volume of lumber sold, rising to 54.0 million board feet for the fourth quarter of 2004 from 32.3 million board feet for the fourth quarter of 2003. This was offset by softening in lumber pricing resulting in lower average sales realizations for the fourth quarter of 2004, falling 10% to \$528 per mfbm from \$585 per mfbm for the comparative period in 2003. Production at the lumbermill was up 48% over the comparative quarter in 2003 to 49.1 million board feet, reflecting benefits realized from recent capital improvements and the preventative maintenance program in place at the lumbermill, as well as the effect of market-related curtailments taken in the prior year period.

Lumber sales for the year ended December 31, 2004 of \$106.2 million were 44% greater than sales of \$73.6 million for 2003. Again, this improvement reflects strong demand in 2004 relative to 2003 as evidenced by a 12% increase in average lumber sales realizations, rising to \$619 per mfbm from \$552 per mfbm for 2003, and a 29% increase in the volume of lumber sold, rising to 171.7 million board feet for 2004 from 133.3 million board feet for 2003. Lumbermill production for 2004 was up 45% over 2003 to 180.7 million board feet, again reflecting the benefits of recent capital improvements and the benefit of a third shift operating at the mill throughout 2004.

Wood chip sales for both the three and twelve month periods ended December 31, 2004, of \$3.1 million and \$12.5 million, respectively, were ahead of sales for the comparative periods in 2003, primarily due to increased wood chip volumes available for sale as a result of the increased production at the Company's lumbermill facility.

Real estate activity for the fourth quarter of 2004 generated revenues of \$7.4 million compared to revenues of \$2.2 million for the fourth quarter of 2003. Real estate activity generated revenues of \$10.8 million in 2004 compared to \$8.9 million generated in 2003. The variance in fourth quarter and annual results reflect the variable nature and timing of real estate sales activity.

## Financial Position

Current assets increased \$18.0 million to \$88.0 million at December 31, 2004, up from \$70.0 million as at December 31, 2003. This increase can be attributed to a cash balance at December 31, 2004 of \$1.6 million, a \$0.3 million increase in accounts receivable and an increase in inventory of \$16.5 million over the prior year. Log inventory value increased \$13.0 million year-over-year to \$54.1 million at December 31, 2004, reflecting a level of log inventory more typical of year end, whereas log inventory levels at the end of 2003 were considered low, a situation that resulted from lost production in November and December 2003 due to labour-related work stoppages. Though private land logging operations were curtailed for most of December 2004, these operations had fulfilled their annual production targets. Lumber inventory increased \$3.7 million year-over-year to \$6.8 million at December 31, 2004, again reflecting a level of inventory more typical of year end than at the end of 2003, as market-related curtailments were taken for three weeks in December 2003 at the lumbermill, resulting in inventory being lower than usual.

Property, plant and equipment of \$1,334.3 million as at December 31, 2004 was \$22.2 million less than at December 31, 2003, primarily reflecting the completion of the sale of TFL 46 during the second quarter of 2004 for a sale price of \$17.9 million and the sale of several higher-use properties during the year for proceeds of \$10.4 million. Other factors contributing to the variance in this balance include a provision for depreciation, depletion and amortization of \$10.1 million in 2004 and the sale of other logging equipment during 2004 for proceeds of \$4.8 million. These items were partially offset by \$8.5 million in additions to property, plant and equipment during 2004.

Other assets were \$12.2 million at December 31, 2004, comparable to the balance of \$14.4 million at December 31, 2003. Other assets are comprised primarily of prepaid pension benefits and deferred debt issue costs.

## TIMBERWEST FOREST CORP.

Current liabilities at the end of 2004 were \$78.2 million, down \$31.8 million from \$110.0 million as at December 31, 2003. Accounts payable and accrued liabilities increased \$6.0 million during 2004, to \$35.5 million at December 31, 2004. Similar to inventory balances, accounts payable and accrued liabilities at December 31, 2003 were at less than normal levels due to production-related curtailments late in the fourth quarter of 2003 and lower stumpage fee accruals due to reduced harvests on Crown tenures during this period. The distribution payable at the end of the fourth quarter of 2004 of \$20.7 million is up slightly from the distribution payable at December 31, 2003, reflecting a consistent per unit distribution and an increase in the number of Stapled Units outstanding at the end of the quarter due to the exercise of options for 660,895 Stapled Units during 2004.

On March 2, 2004, the Company completed and received a renewal of short-term financing from a Canadian bank consisting of an unsecured demand bank guarantee facility in the amount of \$16.0 million and an unsecured 364-day committed revolving facility in the amount of \$40.0 million, both due on March 1, 2005. Under the 364-day facility, funds are available to the Company in both Canadian and US dollars by way of adjusted prime rate-based loans, Canadian dollar bankers' acceptances and letters of credit or guarantee. On May 26, 2004, the Company completed and received a renewal of short-term financing from a second Canadian bank. The renewed financing consists of an unsecured 364-day committed revolving facility in the amount of \$40.0 million that is due on May 25, 2005. Under this 364-day facility, funds are available to the Company by way of Canadian dollar prime rate-based loans, bankers' acceptances, letters of credit or guarantee and US dollar LIBOR. As at December 31, 2004, the Company had combined borrowings of \$22.0 million on its two \$40.0 million unsecured 364-day revolving facilities, a decrease of \$38.0 million from borrowings of \$60.0 million at December 31, 2003.

As at December 31, 2004, long-term credit facilities available to the Company consisted of an unsecured revolving credit facility for \$125.0 million due on December 31, 2006. There were no borrowings on this facility at December 31, 2004 or at December 31, 2003. Long-term financial liabilities as at December 31, 2004, also included \$195.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007.

Other long-term liabilities at December 31, 2004 included a silviculture liability of \$2.8 million, a \$27.1 million liability relating to non-pension post retirement benefits and a future income tax liability of \$224.3 million. The long-term silviculture liability decreased \$1.8 million during 2004, due in part to the transfer of the liability associated with TFL 46 to the purchaser of this tenure and to the revaluation of the silviculture liability at its fair value in compliance with a new accounting standard implemented during the year (see "Accounting Policy Changes – *Asset Retirement Obligations*" in this management's discussion and analysis for further information). The liability for non-pension post-retirement benefits increased \$1.8 million during the year and reflects actuarially updated estimated liabilities as at December 31, 2004. The future income tax liability decreased \$6.2 million during 2004, reflecting a reduction in temporary differences between the net book value and tax value of property, plant and equipment.

During the quarter ended December 31, 2004, options to purchase 334,590 Stapled Units were exercised for proceeds of \$3.9 million, 87 options were cancelled, and 3,220 options expired. During the twelve month period ended December 31, 2004, 313,220 Stapled Unit options were granted, options to purchase 660,895 Stapled Units were exercised for proceeds of \$7.7 million, 10,260 Stapled Unit options were cancelled, and 3,220 options expired. As at February 8, 2005, the Company had 1,157,578 granted and outstanding Stapled Unit option awards and 76,907,017 issued and outstanding Stapled Units.

### Cash Flow and Liquidity

Net cash generated from operations before changes in non-cash working capital for the three months ended December 31, 2004, was \$12.4 million or \$0.16 per weighted average Stapled Unit compared to \$4.5 million or \$0.06 per weighted average Stapled Unit for the corresponding quarter in 2003. Year to date, net cash generated from operations before changes in non-cash working capital was \$85.8 million or \$1.12 per weighted average Stapled Unit compared to \$51.3 million or \$0.67 per weighted average Stapled Unit for the comparative period in 2003. During the fourth quarter of 2004, non-cash working capital increased by \$13.9 million compared to an \$8.0 million decrease reported for the same period in 2003. The increase for the fourth quarter of 2004 reflects the net effect of increases in inventory, prepaid expenses and a decrease in accounts payable and accrued liabilities, offset in part by a decrease in accounts receivable as at December 31, 2004, relative to balances as at September 30, 2004. For the 2004 fiscal year, non-cash working capital increased by \$10.2 million compared to a \$13.2 million decrease for fiscal 2003. The increase in the current year reflects the net effect of increases in accounts receivable and inventory, offset in part by a decrease in prepaid expenses and an increase in accounts payable and accrued liabilities compared to balances at December 31, 2003. These changes can be attributed to non-cash working capital components being at more typical year end levels at the end of 2004 than at the end of 2003 due to increased total production in the fourth quarter of 2004, as discussed previously.

## TIMBERWEST FOREST CORP.

Net cash used in financing activities during the fourth quarter of 2004 was \$12.7 million compared to \$18.3 million used in financing activities in the comparative period of 2003. In the fourth quarter of 2004 the Company made a \$20.6 million distribution to unitholders, comparable to the \$20.5 million paid in the fourth quarter of 2003. During the three months ended December 31, 2004, the Company issued 334,590 Stapled Units for net proceeds of \$3.9 million on the exercise of Stapled Unit options; no Stapled Unit options were exercised in the comparative period of 2003. In the fourth quarter of 2004, \$4.0 million was applied to reduce amounts borrowed on revolving credit facilities compared to \$2.9 million applied to revolving credit facilities in the comparative period in 2003. Net cash used in financing activities during 2004 was \$112.6 million, an increase from the \$48.9 million used in financing activities during 2003. In 2004, the Company made distributions of \$82.3 million to unitholders compared to distributions of \$82.1 million in 2003, the increase reflecting a consistent per unit distribution but a greater number of outstanding Stapled Units in 2004. During 2004, the Company issued 660,895 Stapled Units for net proceeds of \$7.7 million on the exercise of Stapled Unit options, compared to \$0.5 million received on the exercise of options for 53,334 Stapled Units in the comparative period of 2003. During 2004, the Company applied \$38.0 million to reduce amounts borrowed on its revolving credit facilities. In 2003, the Company borrowed \$60.0 million on available credit facilities and completed a public offering of \$65.0 million aggregate principal amount of 7.0% debentures, and utilized most of these funds in the retirement of the Company's 6.5% debentures for \$106.5 million.

Net cash provided by investing activities during the fourth quarter of 2004 was \$8.4 million compared to net cash provided by investing activities of \$5.8 million for the same quarter of 2003. This variance can be attributed to receipt of proceeds from the sale of property, plant and equipment of \$12.0 million in the fourth quarter of 2004, compared to \$4.5 million received for the same period in 2003. These amounts were offset in part by capital expenditures of \$4.0 million in the fourth quarter of 2004 and \$1.0 million incurred in the comparative period of 2003. For the year ended December 31, 2004, net cash provided by investing activities was \$38.6 million compared to net cash used in investing activities of \$1.8 million for 2003. Cash provided by investing activities in 2004 include \$33.3 million in proceeds from the sale of property, plant and equipment compared to \$11.4 million in proceeds for 2003. 2004 proceeds include \$16.2 million cash proceeds received from the sale of TFL 46 and \$10.4 million proceeds received on the sale of higher use properties, while 2003 proceeds include \$8.6 million received on the sale of higher use properties. Capital expenditures for 2004 were \$8.5 million, compared to \$18.0 million incurred in 2003. Additions to property, plant and equipment in 2004 included \$3.5 million for roads and bridges, \$2.0 million for capital improvements at the lumbermill, and \$2.0 million for a new financial reporting system. Significant capital additions in 2003 included \$9.5 million for improvement projects at the lumbermill, including three new lumber drying kilns and the replacement of the trimmer optimizer, \$3.3 million to complete the North Island log sort and \$2.5 million on roadbuilding activities for timberland operations. 2004 cash flows from investing activities also include the expropriation settlement proceeds of \$14.0 million received during the year.

As at December 31, 2004, TimberWest's total debt<sup>2</sup> outstanding was \$217.0 million compared to total debt outstanding of \$255.0 million as at December 31, 2003. The Company's consolidated debt-to-total capitalization ratio<sup>2</sup> as at December 31, 2004, was 19:81, compared to 23:77 as at December 31, 2003. Total debt facilities available to the Company as at December 31, 2004, were \$416.0 million, comprised of \$16.0 million available under the demand bank guarantee facility due March 1, 2005, \$40.0 million available under the 364-day revolving facility due March 1, 2005, \$40.0 million available under the 364-day revolving facility due May 25, 2005, \$125.0 million available under the revolving credit facility maturing on December 31, 2006, and \$195.0 million of 7.0% debentures maturing on October 1, 2007.

---

<sup>2</sup> 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. 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 annual audited consolidated financial statements and, in the Company's opinion, include all normal recurring adjustments necessary for the fair presentation of such information. These financial results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

(in millions of dollars, except per common share and per Stapled Unit amounts)	2003				2004			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	\$ 130.8	\$ 113.3	\$ 105.0	\$ 96.3	\$ 105.4	\$ 136.8	\$ 119.9	\$ 114.9
Operating earnings	\$ 30.5	\$ 10.4	\$ 12.0	\$ 5.8	\$ 28.0	\$ 28.4	\$ 23.0	\$ 15.0
Net earnings (loss) before extraordinary item	\$ 17.7	\$ 1.5	\$ 6.3	\$ (0.7)	\$ 17.1	\$ 21.7	\$ 16.9	\$ 12.2
Extraordinary item, net of applicable income taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 9.0	\$ -
Net earnings (loss)	\$ 17.7	\$ 1.5	\$ 6.3	\$ (0.7)	\$ 17.1	\$ 21.7	\$ 25.9	\$ 12.2
Earnings available for distribution	\$ 25.4	\$ 6.4	\$ 9.6	\$ 0.8	\$ 24.4	\$ 29.1	\$ 33.2	\$ 19.5
Earnings available for distribution before provision for future income taxes	\$ 26.3	\$ 6.4	\$ 8.2	\$ 1.3	\$ 23.6	\$ 29.0	\$ 33.0	\$ 13.2
Distributable cash before extraordinary item	\$ 25.7	\$ 4.7	\$ 12.0	\$ 9.0	\$ 27.7	\$ 43.5	\$ 21.9	\$ 18.1
Distributable cash from extraordinary item	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 14.0	\$ -
Distributable cash	\$ 25.7	\$ 4.7	\$ 12.0	\$ 9.0	\$ 27.7	\$ 43.5	\$ 35.9	\$ 18.1
Distributions paid	\$ 20.5	\$ 20.5	\$ 20.6	\$ 20.5	\$ 20.5	\$ 20.6	\$ 20.6	\$ 20.6
<i>\$ per common share<sup>1</sup></i>								
Basic and diluted net earnings (loss) before extraordinary item	\$ 0.06	\$ (0.19)	\$ (0.14)	\$ (0.26)	\$ 0.05	\$ 0.11	\$ 0.05	\$ (0.02)
Extraordinary item	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 0.11	\$ -
Basic and diluted net earnings (loss) after extraordinary item	\$ 0.06	\$ (0.19)	\$ (0.14)	\$ (0.26)	\$ 0.05	\$ 0.11	\$ 0.16	\$ (0.02)
<i>\$ per Stapled Unit<sup>1</sup></i>								
Basic and diluted earnings available for distribution	\$ 0.33	\$ 0.08	\$ 0.13	\$ 0.01	\$ 0.32	\$ 0.38	\$ 0.43	\$ 0.25
Earnings available for distribution before provision for future income taxes								
- basic	\$ 0.35	\$ 0.08	\$ 0.11	\$ 0.02	\$ 0.31	\$ 0.38	\$ 0.43	\$ 0.17
- diluted	\$ 0.34	\$ 0.08	\$ 0.11	\$ 0.02	\$ 0.31	\$ 0.38	\$ 0.43	\$ 0.17
Basic and diluted distributable cash before extraordinary item	\$ 0.34	\$ 0.06	\$ 0.15	\$ 0.12	\$ 0.36	\$ 0.57	\$ 0.29	\$ 0.24
Basic and diluted distributable cash from extraordinary item	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 0.18	\$ -
Basic and diluted distributable cash	\$ 0.34	\$ 0.06	\$ 0.15	\$ 0.12	\$ 0.36	\$ 0.57	\$ 0.47	\$ 0.24
Distributions paid	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27

<sup>1</sup> 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.

## Accounting Policy Changes

### *Generally accepted accounting principles:*

Effective January 1, 2004, the Canadian Institute of Chartered Accountants (CICA) introduced new recommendations under CICA Handbook Section 1100 – *Generally Accepted Accounting Principles*, which, among other things, provides guidance on alternate sources to consult with when an issue is not specifically addressed by Canadian GAAP. Previously, the Company, along with others in the forest industry, presented lumber sales net of shipping, handling costs and countervailing and anti-dumping duties. In addition, the Company previously presented shipping and handling costs recovered from customers on logs sales netted with cost of sales. As a result of applying this standard, shipping and handling costs recovered from customers are included in sales, while shipping and handling costs incurred are included in cost of sales. Further, countervailing and anti-dumping duties, which previously were presented as a deduction to gross lumber sales, have also been reclassified to cost of sales in accordance with this new GAAP standard. The prior period has been reclassified for comparability. For information purposes, as a result of the reclassification of these amounts, sales and cost of sales reported for the three months ended December 31, 2004, are \$6.3 million higher (2003 - \$4.0 million) and sales and cost of sales reported for the year ended December 31, 2004, are \$21.5 million higher (2003 - \$16.9 million) than they would have been had this reclassification not been made. This change has no effect on operating earnings, net earnings or cash flows.

### *Asset retirement obligations:*

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

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

### *Employee future benefits:*

During 2004, the Company adopted amendments to CICA Handbook Section 3461 – *Employee Future Benefits*. Section 3461 establishes standards for the recognition, measurement and disclosure of the cost of employee future benefits. In January 2004, the CICA amended Section 3461 to require additional disclosures about the assets, cash flows and net periodic benefit cost of pension and other post-retirement benefit plans. The new annual disclosures are effective for years ending on or after June 30, 2004, and new interim disclosures were effective for periods ending on or after that date. The additional disclosures required for the Company's pension plans and other post-retirement plans are presented in note 10 of the accompanying unaudited interim consolidated financial statements.

### *Impairment of long-lived assets:*

Effective January 1, 2004, the Company adopted the new recommendations of CICA Handbook Section 3063 – *Impairment of Long-lived Assets*. Section 3063 establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets by profit-oriented enterprises. The new recommendations require the Company to test long-lived assets for impairment in value whenever events or changes in circumstances indicate their carrying value may not be recoverable. An impairment loss is recognized, if at the date it is tested for impairment, the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and/or eventual disposition. If an impairment loss exists, the loss is measured as the amount by which the carrying amount of the long-lived asset exceeds its fair value. Adoption of this standard resulted in no effect on the Company's consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Future Accounting Standard Change

### *Liabilities and equity:*

Effective January 1, 2005, the Company will adopt amendments to CICA Handbook Section 3860 – *Financial Instruments: Disclosure and Presentation*. Section 3860 establishes standards for the balance sheet presentation of financial instruments or their components as liabilities or equity. The revision to Section 3860 requires obligations that may be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. The revision is effective for all fiscal years beginning on or after November 1, 2004.

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

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

Given that the number of shares required to retire the Subordinate Note component is not fixed, the revision to Section 3860 requires that the Company reclassify the Series A Subordinate Note component of the Stapled Unit from equity to liabilities. Had the revision to Section 3860 been implemented by the Company at December 31, 2004, the reclassification of the Subordinate Note component of the Stapled Units from equity to liabilities would have been \$690.5 million (2003 – \$684.6 million).

Further, holders of the Company's 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 Company's consolidated financial statements, interest payments on Stapled Units are currently charged directly to retained earnings, on an after-tax basis, as a distribution similar to dividends on common shares. The revision to Section 3860 will require distributions on Stapled Units to be reported, on a pre-tax basis, as an interest expense on the statement of operations. This revision also requires the tax benefit provided by the distributions to be reported as a component of the income tax provision on the statement of operations. Distributions on Stapled Units for fiscal 2004 were \$82.5 million (2003 – \$82.1 million) and the tax benefit recognized thereon was \$29.3 million (2003 – \$17.4 million). Had the revision to Section 3860 been implemented by the Company at December 31, 2004, a net charge to earnings of \$53.2 million (2003 – \$64.7 million) would have been required for the year then ended.

## Outlook

Having had an outstanding year in 2004, TimberWest is approaching 2005 with more caution. Economic reports indicate GDP growth in the US will slow in 2005 and analysts are predicting housing starts will decline to 1.84 million from 1.94 million in 2004. While we do not see this happening in the very near term, we are anticipating that this will be the case for the back half of the year. As such, we expect the US log and lumber market to become oversupplied later in the year, depressing prices for our products in that market. While fir and hemlock remain strong in this market, we are starting the year off with weak cedar and alder prices as both of these species are in an oversupply situation in the US Pacific Northwest.

In terms of Japan, there are expectations of a long and sustained recovery fueled by strong household balance sheets, excellent consumer confidence, accommodating monetary policy and rapid export growth. However, for 2005 housing starts are expected to remain flat which means demand for log and lumber products is not expected to grow in this market this year. As we begin the year, demand and pricing for North American logs is stable in Japan. However, the Japanese lumber market is oversupplied causing some weakness in pricing across most of our products destined for that market. We expect this oversupply situation to work its way out by mid-year, with pricing firming up in the back half of the year as a result.

The negative effects of these supply/demand issues could be exacerbated by the rapid appreciation we have seen in the Canadian dollar – with the dollar appreciating a further 10% in the last few months of 2004. While many



## TIMBERWEST FOREST CORP.

economists think that this pace of appreciation is unsustainable in the medium term, in the short run it is reducing our competitiveness.

The Company is continuing with its Business Transformation program and has begun the year with all of its harvesting and road building activity contracted out. This will result in lower costs and improved flexibility, both of which are expected to improve the competitiveness of the organization over time. We are pleased with the start up of our new contractors considering the challenging weather conditions they faced in early January.

The BC government has not fully implemented its forest policy changes. While progress has been made and new investment is beginning to take place on the Coast, the tenure take-backs and the greatly expanded BC Timber Sales program, which provides the foundation for a market-based stumpage system, have not been completed. These changes are key to unleashing competitive market forces on the Coast and we encourage the government to keep moving towards completion of these initiatives. Further consolidation in the sawmilling sector is also expected on the Coast.

For the first time since TimberWest's inception, Elk Falls has generated a strong return on capital, however, the mill has not consistently generated an adequate return and will be challenged for 2005.

We expect 2005 capital expenditure levels to be about the same as they were in 2004 and that 2005 real estate sales will be somewhat lower.

In spite of some expected challenges in our markets we expect to meet distributable cash requirements for 2005.

*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, 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 December 31		Twelve months ended December 31	
	2004	2003	2004	2003
Sales	\$ 114.9	\$ 96.3	\$ 477.0	\$ 445.4
Operating costs and expenses:				
Cost of sales	93.3	85.1	358.0	363.4
Selling, administrative and other	4.2	2.9	14.5	13.5
Depreciation, depletion and amortization	2.4	2.5	10.1	9.8
	99.9	90.5	382.6	386.7
Operating earnings	15.0	5.8	94.4	58.7
Interest expense	4.2	4.3	16.2	16.0
Amortization of deferred financing costs	0.2	0.3	1.1	1.4
Other income (note 4)	(2.7)	(0.4)	(8.2)	(1.8)
	1.7	4.2	9.1	15.6
Earnings before income taxes and extraordinary item	13.3	1.6	85.3	43.1
Income tax expense (note 5)	1.1	2.3	17.4	18.3
Earnings (loss) before extraordinary item	12.2	(0.7)	67.9	24.8
Extraordinary item – expropriation settlement proceeds, net of applicable income taxes (note 6)	–	–	9.0	–
Net earnings (loss)	\$ 12.2	\$ (0.7)	\$ 76.9	\$ 24.8
<i>Basic and diluted earnings (loss) per common share before extraordinary item (note 7)</i>	\$ (0.02)	\$ (0.26)	\$ 0.19	\$ (0.52)
<i>Extraordinary item, net of applicable income taxes, per common share</i>	–	–	0.12	–
<i>Basic and diluted net earnings (loss) per common share (note 7)</i>	\$ (0.02)	\$ (0.26)	\$ 0.31	\$ (0.52)

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

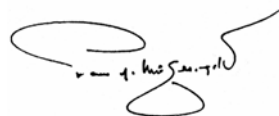
## Consolidated Balance Sheets

(in millions of dollars)

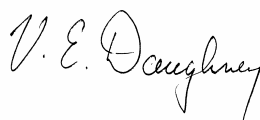
	As at December 31, 2004 <i>Unaudited</i>	As at December 31, 2003
<b>Assets</b>		
Current assets:		
Cash	\$ 1.6	\$ —
Accounts receivable	14.7	14.4
Inventories	62.2	45.7
Prepaid expenses and other current assets	5.7	7.3
Future income taxes	3.8	2.6
	<b>88.0</b>	70.0
Property, plant and equipment, net (note 8)	1,334.3	1,356.5
Other assets	12.2	14.4
	<b>\$ 1,434.5</b>	<b>\$ 1,440.9</b>
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Revolving credit facilities (note 9)	\$ 22.0	\$ 60.0
Accounts payable and accrued liabilities	35.5	29.5
Distribution payable	20.7	20.5
	<b>78.2</b>	110.0
Debentures	195.0	195.0
Long-term silviculture liability	2.8	4.6
Non-pension post-retirement benefits	27.1	25.3
Future income taxes	224.3	230.5
	<b>527.4</b>	565.4
Unitholders' equity:		
Stapled Units, consisting of Series A Subordinate Notes, preferred shares and common shares	878.3	870.6
Contributed surplus	0.4	0.2
Retained earnings	28.4	4.7
	<b>907.1</b>	875.5
	<b>\$ 1,434.5</b>	<b>\$ 1,440.9</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 December 31		Twelve months ended December 31	
	2004	2003	2004	2003
<b>Cash provided by (used in):</b>				
<b>Operating activities:</b>				
Earnings before income taxes and extraordinary item	\$ 13.3	\$ 1.6	\$ 85.3	\$ 43.1
Cash income taxes (note 5)	(0.1)	(0.3)	(0.5)	(0.9)
	13.2	1.3	84.8	42.2
Items not involving cash:				
Depreciation, depletion and amortization	2.6	2.8	11.2	11.2
Gain on sale of property, plant and equipment	(6.5)	(0.9)	(12.4)	(3.7)
Other non-cash items	3.1	1.3	2.2	1.6
	12.4	4.5	85.8	51.3
Changes in non-cash working capital:				
Accounts receivable	9.0	9.8	(0.3)	9.7
Inventories	(6.0)	9.5	(16.5)	21.6
Prepaid expenses and other working capital	(1.7)	0.6	0.4	(1.6)
Accounts payable and accrued liabilities	(15.2)	(11.9)	6.2	(16.5)
	(1.5)	12.5	75.6	64.5
<b>Financing activities:</b>				
Distributions paid to unitholders	(20.6)	(20.5)	(82.3)	(82.1)
Issuance of Stapled Units on exercise of options	3.9	—	7.7	0.5
Revolving credit facilities	4.0	2.9	(38.0)	60.0
Issuance of 7.0% debentures	—	—	—	65.8
Redemption of 6.5% debentures	—	—	—	(106.5)
Deferred debt issue costs	—	(0.7)	—	(1.4)
	(12.7)	(18.3)	(112.6)	(63.7)
<b>Investing activities:</b>				
Proceeds from sale of property, plant and equipment	12.0	4.5	33.3	11.4
Additions to property, plant and equipment	(4.0)	(1.0)	(8.5)	(18.0)
Other assets	0.4	2.3	(0.2)	4.8
Expropriation settlement proceeds (extraordinary item (note 6))	—	—	14.0	—
	8.4	5.8	38.6	(1.8)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(5.8)</b>	<b>—</b>	<b>1.6</b>	<b>(1.0)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>7.4</b>	<b>—</b>	<b>—</b>	<b>1.0</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1.6</b>	<b>\$ —</b>	<b>\$ 1.6</b>	<b>\$ —</b>
<b>Supplemental information:</b>				
Interest paid	\$ 7.4	\$ 6.1	\$ 16.0	\$ 18.0
Income taxes paid	\$ 0.2	\$ 0.3	\$ 0.8	\$ 0.9

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Consolidated Statements of Unitholders' Equity

(in millions of dollars)  
Unaudited

	Stapled Units		Contributed surplus	Retained earnings	Total unitholders' equity
	Number	Amount			
<b>Twelve months ended December 31, 2003:</b>					
Balance, December 31, 2002	76,192,788	\$ 870.1	\$ 0.1	\$ 44.6	\$ 914.8
Issuance of Stapled Units on exercise of options	53,334	0.5	—	—	0.5
Stapled Unit option awards	—	—	0.1	—	0.1
Net earnings	—	—	—	24.8	24.8
Interest on Series A Subordinate Notes	—	—	—	(82.1)	(82.1)
Income tax benefit thereon (note 5)	—	—	—	17.4	17.4
<b>Balance, December 31, 2003</b>	<b>76,246,122</b>	<b>\$ 870.6</b>	<b>\$ 0.2</b>	<b>\$ 4.7</b>	<b>\$ 875.5</b>
<b>Twelve months ended December 31, 2004:</b>					
Balance, December 31, 2003	76,246,122	\$ 870.6	\$ 0.2	\$ 4.7	\$ 875.5
Issuance of Stapled Units on exercise of options	<b>660,895</b>	<b>7.7</b>	—	—	<b>7.7</b>
Stapled Unit option awards	—	—	<b>0.2</b>	—	<b>0.2</b>
Net earnings	—	—	—	<b>76.9</b>	<b>76.9</b>
Interest on Series A Subordinate Notes	—	—	—	<b>(82.5)</b>	<b>(82.5)</b>
Income tax benefit thereon (note 5)	—	—	—	<b>29.3</b>	<b>29.3</b>
<b>Balance, December 31, 2004</b>	<b>76,907,017</b>	<b>\$ 878.3</b>	<b>\$ 0.4</b>	<b>\$ 28.4</b>	<b>\$ 907.1</b>

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2004 and 2003

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

### 1. Significant Accounting Policies

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, 2003, except for the accounting policy changes as described in note 2.

### 2. Change in Accounting Policies

Generally accepted accounting principles:

Effective January 1, 2004, the Canadian Institute of Chartered Accountants (CICA) introduced new recommendations under CICA Handbook Section 1100 – *Generally Accepted Accounting Principles*, which, among other things, provides guidance on alternate sources to consult with when an issue is not specifically addressed by Canadian GAAP. Previously, the Company, along with others in the forest industry, presented lumber sales net of shipping, handling costs and countervailing and anti-dumping duties. In addition, the Company previously presented shipping and handling costs recovered from customers on logs sales netted with cost of sales. As a result of applying this standard, shipping and handling costs recovered from customers are included in sales, while shipping and handling costs incurred are included in cost of sales. Further, countervailing and anti-dumping duties, which previously were presented as a deduction to gross lumber sales, have also been reclassified to cost of sales in accordance with this new GAAP standard. The prior period has been reclassified for comparability. For information purposes, as a result of the reclassification of these amounts, sales and cost of sales reported for the three months ended December 31, 2004, are \$6.3 million higher (2003 - \$4.0 million) and sales and cost of sales reported for the year ended December 31, 2004, are \$21.5 million higher (2003 - \$16.9 million) than they would have been had this reclassification not been made. This change has no effect on operating earnings, net earnings or cash flows.

Asset retirement obligations:

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

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

Employee future benefits:

During 2004, the Company adopted amendments to CICA Handbook Section 3461 – *Employee Future Benefits*. Section 3461 establishes standards for the recognition, measurement and disclosure of the cost of employee future benefits. In January 2004, the CICA amended Section 3461 to require additional disclosures about the assets, cash flows and net periodic benefit cost of pension and other post-retirement benefit plans. The new annual disclosures are effective for years ending on or after June 30, 2004, and new interim disclosures were effective for periods ending on or after that date. The additional disclosures required for the Company's pension plans and other post-retirement plans are presented in note 10.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2004 and 2003

### 2. Change in Accounting Policies (continued)

Impairment of long-lived assets:

Effective January 1, 2004, the Company adopted the new recommendations of CICA Handbook Section 3063 – *Impairment of Long-lived Assets*. Section 3063 establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets by profit-oriented enterprises. The new recommendations require the Company to test long-lived assets for impairment in value whenever events or changes in circumstances indicate their carrying value may not be recoverable. An impairment loss is recognized, if at the date it is tested for impairment, the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and/or eventual disposition. If an impairment loss exists, the loss is measured as the amount by which the carrying amount of the long-lived asset exceeds its fair value. Adoption of this standard resulted in no effect on the Company's consolidated financial statements.

### 3. Future Accounting Change

Liabilities and equity:

Effective January 1, 2005, the Company will adopt amendments to CICA Handbook Section 3860 – *Financial Instruments: Disclosure and Presentation*. Section 3860 establishes standards for the balance sheet presentation of financial instruments or their components as liabilities or equity. The revision to Section 3860 requires obligations that may be settled at the issuer's option by a variable number of the issuer's own equity instruments to be presented as liabilities. The revision is effective for all fiscal years beginning on or after November 1, 2004.

The revised standard will require the Company to reclassify the Series A Subordinate Note component of the Company's Stapled Units from equity to liabilities as the Series A Subordinate Notes may be settled by a variable number of the Company's common shares. Had this revision been implemented at December 31, 2004, \$690.5 million (2003 – \$684.6 million) in Series A Subordinate Notes currently included as a component of Stapled Units under unitholders' equity would have been presented as financial liabilities in the Company's consolidated balance sheets. Further, distributions on the Series A Subordinate Notes must also be reclassified from their current presentation as a charge directly to retained earnings, on an after-tax basis, in the consolidated statements of unitholders' equity to interest expense, on a pre-tax basis, in the consolidated statements of operations. Had this revision been implemented at December 31, 2004, a net charge to earnings of \$13.4 million (2003 – \$19.0 million) would have been required for the three month period ended December 31, 2004, and a net charge to earnings of \$53.2 million (2003 – \$64.7 million) would have been required for the year then ended.

### 4. Sale of Tree Farm Licence 46

On May 6, 2004, the Company completed the sale of its southern Vancouver Island public land operations, referred to as Tree Farm Licence 46 (TFL 46). TFL 46 represented part of the Company's public land logging business, included timber rights to an annual allowable cut of approximately 500,000 m<sup>3</sup> on 76,574 hectares of Crown land and had been operated by TimberWest as part of its Honeymoon Bay operation on southwest Vancouver Island.

The sale price for these assets was \$17.9 million. Under the terms of the sale, silviculture liabilities of \$0.4 million were assumed by the purchaser and leased equipment with a value of \$6.0 million was transferred to the purchaser, relieving the Company of commitments for future payments under operating leases in the amount of \$2.6 million. The gain on the sale of these operations has been included in other income on the consolidated statements of operations.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2004 and 2003

### 5. Income Taxes

	Three months ended December 31		Twelve months ended December 31	
	2004	2003	2004	2003
Current income tax expense				
Large corporation tax	\$ 0.2	\$ 0.3	\$ 0.4	\$ 0.9
Income tax benefit on interest on Series A Subordinate Notes charged directly to distributions	7.3	1.5	22.0	17.4
	7.5	1.8	22.4	18.3
Future income tax (expense) recovery	(5.2)	0.5	(6.1)	–
	\$ 2.3	\$ 2.3	\$ 16.3	\$ 18.3

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

### 6. Extraordinary Item – Expropriation Settlement Proceeds

On September 24, 2004, the Company received \$14.0 million from the Province of British Columbia as settlement for the 1995 expropriation of timber harvesting rights in the Walbran Valley and Hitchie Creek areas for park creation purposes under the *Park Amendment Act, 1995* (British Columbia). The \$14.0 million proceeds from this settlement have been accounted for as an extraordinary item in the consolidated statements of earnings, net of \$5.0 million in income taxes effected at statutory tax rates. As the Company has non-capital losses carried forward from previous taxation years, income taxes will not be paid on the proceeds from this settlement. The future income tax expense on earnings before the extraordinary item for the twelve months ended December 31, 2004, has been reduced by \$5.0 million to recognize the benefit of the losses utilized and fully offsets the tax expense charged to the extraordinary item.

### 7. Earnings per Share

	Three months ended December 31		Twelve months ended December 31	
	2004	2003	2004	2003
Earnings (loss) before extraordinary item	\$ 12.2	\$ (0.7)	\$ 67.9	\$ 24.8
Less: Distributions on Series A Subordinate Notes	(20.7)	(20.5)	(82.5)	(82.1)
Tax benefit thereon	7.3	1.5	29.3	17.4
	(13.4)	(19.0)	(53.2)	(64.7)
Earnings (loss) before extraordinary item attributable to common shares	(1.2)	(19.7)	14.7	(39.9)
Extraordinary item, net of applicable income taxes (note 4)	–	–	9.0	–
Net earnings (loss) attributable to common shares	\$ (1.2)	\$ (19.7)	\$ 23.7	\$ (39.9)

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2004 and 2003

### 7. Earnings per Share (continued)

	Three months ended December 31		Twelve months ended December 31	
	2004	2003	2004	2003
Basic weighted average number of common shares	76,809,113	76,246,122	76,523,531	76,234,486
Incremental common shares from potential exercise of options	181,360	74,906	105,681	74,597
Diluted weighted average number of common shares	76,990,473	76,321,028	76,629,212	76,309,083
Basic and diluted earnings (loss) before extraordinary item per common share	\$ (0.02)	\$ (0.26)	\$ 0.19	\$ (0.52)
Extraordinary item, net of applicable income taxes, per common share	-	-	0.12	-
Basic and diluted net earnings (loss) per common share	\$ (0.02)	\$ (0.26)	\$ 0.31	\$ (0.52)

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.

### 8. Property, Plant and Equipment

Property, plant and equipment at December 31, 2004, include \$1,214.0 million carrying value for private timberlands. 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.

### 9. Revolving Credit Facilities

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

On May 26, 2004, the Company completed and received a renewal of short-term financing from a Canadian bank. The renewed financing consists of an unsecured 364-day committed revolving facility in the amount of \$40.0 million that is due on May 25, 2005. Under the 364-day facility, funds are available to the Company by way of Canadian dollar prime rate-based loans, bankers' acceptances, letters of credit or guarantee and US dollar LIBOR.

As at December 31, 2004, the Company had combined borrowings of \$22.0 million on its two \$40.0 million unsecured 364-day revolving facilities. As at December 31, 2004, there were no borrowings on the Company's \$125.0 million unsecured revolving credit facility.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2004 and 2003

### 10. Employee Benefits

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. The triennial actuarial valuation of the Company's pension obligations as at December 31, 2003, was completed during the first quarter of 2004. The valuation identified a going-concern deficit of \$3.9 million and a solvency deficit of \$5.1 million for the defined benefit segment of the Company's pension benefit plans. Based on the results of the valuation, commencing in 2004, the Company is required to fund annual current service costs of approximately \$1.4 million, including required contributions under both the defined benefit and defined contribution segments of the plans. In addition, the Company is required to fund the deficit position in the defined benefit plans with annual costs of approximately \$1.2 million.

For the three months ended December 31, 2004, the Company recorded an expense of \$0.9 million for pension benefit costs (2003 – \$1.0 million) and made cash payments of \$1.5 million to fund current and future service costs (2003 – \$0.2 million). For the twelve months ended December 31, 2004, the Company recorded an expense of \$3.2 million for pension benefit costs (2003 – \$3.7 million) and made cash payments of \$2.8 million to fund current and future service costs (2003 – \$0.8 million).

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 December 31, 2004, the Company recorded an expense of \$0.8 million for non-pension benefit costs (2003 – \$1.3 million) and made cash payments of \$0.5 million to fund current and future benefit costs (2003 – \$0.5 million). For the twelve months ended December 31, 2004, the Company recorded an expense of \$3.5 million for non-pension benefit costs (2003 – \$3.4 million) and made cash payments of \$1.8 million to fund current and future benefit costs (2003 – \$1.8 million).

### 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. During the quarter ended December 31, 2004, no Stapled Unit options were granted (2003 – nil). For the twelve months ended December 31, 2004, 313,220 Stapled Unit options were granted at an average exercise price of \$12.21 (2003 – 267,047 Stapled Unit options were granted at an average exercise price of \$11.90).

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

	2004	2003
Risk-free interest rate	3.5%	4.3%
Expected life (years)	5.0	5.0
Expected volatility	20.6%	25.3%
Dividend yield	8.6%	9.1%
Number of options granted	313,220	267,047
Fair value of options granted (dollars)	\$0.86	\$1.07

The compensation cost for the 313,220 Stapled Unit options granted between January 1, 2004 and December 31, 2004 is \$269,000 (2003 – 267,047 Stapled Unit options were granted with a compensation cost of \$285,000). 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 \$45,000 and \$179,000 has been recognized in net earnings for the three and twelve month periods ended December 31, 2004, respectively, (2003 – \$24,000 and \$87,000, respectively,) for option awards made during fiscal 2004 and 2003, with a corresponding credit to contributed surplus.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2004 and 2003

### 11. Stock-based Compensation Plans (continued)

Had the Company used the fair value method to account for Stapled Unit options granted during 2002, there would have been no adjustment to net earnings and earning per common share reported for the three and twelve month periods ended December 31, 2004 and 2003, as the stock-based compensation cost related to these options was nominal.

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 December 31, 2004, \$0.3 million has been accrued for awards granted under this plan (2003 – \$0.3 million) and \$0.3 million has been amortized against earnings for the quarter (2003 – \$0.3 million). For the twelve months ended December 31, 2004, \$1.3 million has been accrued for awards granted under this plan (2003 – \$1.2 million) and \$1.3 million has been amortized against earnings (2003 – \$1.1 million).

During the three months ended December 31, 2004, a total of 334,590 Stapled Unit options with an average exercise price of \$11.65 were exercised, 87 Stapled Unit options with an average exercise price of \$11.90 were cancelled and 3,220 Stapled Unit options with an average exercise price of \$11.90 expired (2003 – no Stapled Unit options were exercised, no options were cancelled and no options expired). For the twelve months ended December 31, 2004, a total of 660,895 Stapled Unit options with an average exercise price of \$11.64 were exercised, 10,260 Stapled Unit options with an average exercise price of \$12.08 were cancelled, and 3,220 Stapled Unit options with an average exercise price of \$11.90 expired (2003 – 53,334 Stapled Unit options with an average exercise price of \$8.91 were exercised, 9,367 Stapled Unit options with an average exercise price of \$12.95 were cancelled and no options expired).

### 12. Business Transformation

On June 24, 2004, the Company announced a plan to transform its business model through a restructuring of the Company's log harvesting operations and a move to contract out all logging activities. Historically, 50 percent of the Company's log harvesting was performed by contractors. Under the transformation plan, the Company has contracted out the remainder of its logging activities to unionized contractors on a competitive-bid basis, effective January 1, 2005.

Operating earnings for the three and twelve month periods ended December 31, 2004, reflect an expense of \$1.9 million and \$4.6 million, respectively, in cost of sales for costs relating to this restructuring.

### 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  
December 31

Twelve months ended  
December 31

2004 2003

2004 2003

### Sales by Product

(in millions of dollars)

	2004	2003	2004	2003
Log sales				
Domestic	\$ 38.1	\$ 41.0	\$ 181.6	\$ 178.4
Export – Asia	26.8	22.6	109.3	106.6
Export – US	8.9	6.2	46.7	55.1
Total log sales	73.8	69.8	337.6	340.1
Lumber	28.5	18.9	106.2	73.6
Wood chips and other	5.2	5.4	22.4	22.8
Real estate	7.4	2.2	10.8	8.9
	\$ 114.9	\$ 96.3	\$ 477.0	\$ 445.4

### Sales Volume

Logs (thousand m<sup>3</sup>)

Domestic	432.9	534.5	2,099.9	2,082.7
Export – Asia	180.4	160.5	694.4	692.2
Export – US	97.1	71.6	457.8	613.8
	710.4	766.6	3,252.1	3,388.7

Lumber (million fbm)

54.0 32.3 171.7 133.3

### Log Sales Mix (thousand m<sup>3</sup>)

Fir	458.4	283.3	1,905.2	1,795.6
Hembal	127.2	328.2	730.1	988.4
Cedar	66.2	66.6	322.4	337.4
Other	58.6	88.5	294.4	267.3
	710.4	766.6	3,252.1	3,388.7

### Production Volume

Logs (thousand m<sup>3</sup>)

Public tenures	120.9	129.0	864.3	671.5
Private timberlands	587.7	589.3	2,541.3	2,461.1
	708.6	718.3	3,405.6	3,132.6

Lumber (million fbm)

49.1 33.2 180.7 124.7

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

(in millions of dollars)

Net earnings	\$ 12.2	\$ (0.7)	\$ 76.9	\$ 24.8
Add (deduct):				
Interest expense	4.2	4.3	16.2	16.0
Income tax expense	1.1	2.3	17.4	18.3
Depreciation, depletion and amortization	2.4	2.5	10.1	9.8
Amortization of deferred financing costs	0.2	0.3	1.1	1.4
Extraordinary item, net of income taxes	–	–	(9.0)	–
EBITDA	\$ 20.1	\$ 8.7	\$ 112.7	\$ 70.3

\* 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 and runs fully contracted out harvesting operations. The Company's 334,000 hectares, providing a sustainable annual harvest of 2.5 million m<sup>3</sup> of logs, are located on Vancouver Island and predominantly support the growth of Douglas fir forests, a premium species used for structural purposes. With almost 70% of its logging now being done in second growth stands, TimberWest leads the industry in this segment. Third party auditors have certified that the management of the Company's private forest land conforms to the objectives and performance measures of the American Forest and Paper Association's Sustainable Forestry Initiative (SFI<sup>®</sup>). The computation of the Company's recently revised long-run sustainable yield will be validated by the Company's external SFI<sup>®</sup> auditor, KPMG Performance Registrar Inc., in the first half of 2005. TimberWest also owns renewable Crown harvest rights to 0.8 million m<sup>3</sup> of logs per year and operates a lumbermill located near Campbell River, BC. In addition, approximately 6,000 hectares of the Company's private forest lands have been identified as having greater value as real estate properties and are progressively being made available for higher uses.

## TimberWest Forest Corp.

Suite 2300, 1055 West Georgia Street  
PO Box 11101  
Vancouver, BC V6E 3P3  
Telephone: 604-654-4600

Investor Relations Contact:  
Bev Park  
Vice-President, Finance and  
Chief Financial Officer  
Telephone: 604-654-4600  
Facsimile: 604-654-4662  
Email: [invest@timberwest.com](mailto:invest@timberwest.com)

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)

