



**TimberWest**

Industry leader in second-growth harvesting

**Q-4**  
2006

Fourth Quarter  
Interim Report

For the three & twelve months  
ended December 31, 2006

[www.timberwest.com](http://www.timberwest.com)  
TSX: TWF.UN



# TIMBERWEST FOREST CORP.

## To Our Unitholders,

I am pleased to report that TimberWest generated distributable cash of \$27.5 million, or \$0.35 per stapled unit for the fourth quarter, and \$103.8 million of distributable cash, or \$1.34 per unit, for the year 2006. This compares to \$29.7 million of distributable cash for the fourth quarter of 2005, or \$0.38 per unit, and \$67.3 million or \$0.87 per unit, for the year 2005.

### Operational Results

Timberland results were weaker than this quarter last year primarily because of the low volume of log shipments. We shipped 644,000 m<sup>3</sup> during the quarter, down from 990,000 m<sup>3</sup> during the fourth quarter of 2005, to bring total shipments for the year to 3.1 million m<sup>3</sup> (compared to 3.6 million m<sup>3</sup> last year). Weather-related production curtailments limited volume in both the third and fourth quarters this year. As a result, we had less available to sell into both domestic and export markets. In spite of weakness in the US log market, sales realizations for the quarter were strong at \$96 per m<sup>3</sup> with demand from Japan remaining robust. Sales realizations in the fourth quarter of 2005 were \$90 per m<sup>3</sup>. We finished the year with average sales realizations higher than last year as well; \$98 per m<sup>3</sup> compared to \$91 per m<sup>3</sup>. Unfortunately, production costs increased by \$3.25 per m<sup>3</sup> for the year, primarily the result of higher input costs for our contractors.

Real estate sales were strong for the quarter and the year with net proceeds of \$13.9 million and \$32.9 million respectively. Values remained strong across our entire real estate portfolio on Vancouver Island. We sold real estate this quarter from Campbell River in the northern part of our holdings down to Sooke, the southern most part of our holdings and this was representative of our experience for the year. We sold properties with a wide range of end uses from residential, commercial, recreational, resort, and industrial, to small tree farms. The values varied by ultimate end use but averaged about \$25,000 per hectare, or \$10,000 per acre, for land sold this year. Sales where entitlement work was done averaged \$50,000 per acre. Our search for a new Vice President to help us surface these values is progressing well.

Our Elk Falls lumber mill performed better this year but not well enough to encourage an offer from any prospective buyers. The mill is heavily focused on Japan and, with the Japanese lumber market remaining strong throughout 2006, it was able to run on three shifts all year. The sales process for the mill was still underway at year end with a final prospective purchaser performing due diligence. Countervailing duty refunds of \$3.4 million were received during the quarter, which included interest in the amount of \$0.4 million.

### Outlook

In the near term, we continue to expect prices for logs and lumber to be weak in the US market while remaining strong in other markets. Weather-related curtailments throughout our region are causing log shortages, placing upward pressure on domestic log prices but also making it increasingly difficult to sell into export markets as local mills continue to block our export shipments using federal Notice 102. Proceedings on our Notice 102 lawsuit concluded in 2006 and we received a ruling from the Federal Court of Canada on February 8, 2007. The action was dismissed and we are disappointed with the outcome. We have thirty days to file a Notice of Appeal.

Margins in our core timberlands business are expected to be comparable to 2006 levels for 2007 while the sawmill's performance is expected to weaken as competition intensifies in the Japanese market. The collective agreement with the United Steelworkers Union expires in June 2007.

We expect to see real estate values hold on Vancouver Island and are looking forward to 2007 being another good sales year and a transition year for our real estate business unit as we build our organization and develop a longer range plan for our value-added activities.

While the US housing market is expected to remain weak in the short run, long term prospects for log demand from our region are very good. With Asia continuing to increase its demand for logs and lumber, with positive demographics in the US expected to result in the return to a strong housing market, and with



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the inevitable future supply shortages caused by the Mountain Pine Beetle infestation in the BC Interior and further harvest level reductions in eastern Canada, we believe demand and pricing for log and lumber products in our region will improve.

We are starting 2007 in a strong financial position and we expect to generate sufficient distributable cash in the year from both real estate and forestry operations to fund all of our unitholder distributions.

On behalf of the Board of Directors

A handwritten signature in black ink, appearing to read "Paul J. McElligott". The signature is stylized with loops and a long tail.

Paul J. McElligott  
President and Chief Executive Officer

Vancouver, British Columbia  
February 8, 2007

# TIMBERWEST FOREST CORP.

## Management's Discussion and Analysis

### For the three and twelve months ended December 31, 2006 and 2005

Management's Discussion and Analysis supplements, but does not form part of, the unaudited interim consolidated financial statements of TimberWest Forest Corp. ("TimberWest" or "the Company") and the notes thereto for the fourth quarter of 2006. 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 2006 relative to the fourth quarter and year to date of 2005, and that have affected the Company's financial position as at December 31, 2006, relative to December 31, 2005. Factors that could affect future operations are also discussed. These factors may be affected by known and unknown risks and uncertainties that may cause the actual future results of the Company to be materially different than those expressed or implied in this discussion. These risks and uncertainties are described herein and in the Management's Discussion and Analysis contained in the Company's 2005 Annual Report.

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

This Management's Discussion and Analysis has been prepared based on information available as at February 8, 2007.

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

### Distributable Cash

<i>(in millions of dollars)</i>	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
Net earnings	\$ 14.8	\$ 30.9	\$ 17.1	\$ 4.8
Interest on Series A Subordinate Notes owned by unitholders	20.9	20.9	83.6	83.3
Earnings available for distribution	35.7	51.8	100.7	88.1
Future income tax recovery	(13.2)	(27.5)	(38.2)	(38.1)
Earnings available for distribution before provision for future income taxes	22.5	24.3	62.5	50.0
Add (deduct):				
Depreciation, depletion and amortization	2.0	2.3	8.8	9.5
Proceeds from sale of property, plant and equipment	13.9	9.8	33.0	42.8
Gain on sale of property, plant and equipment	(10.9)	(6.8)	(14.9)	(13.0)
Additions to property, plant and equipment	(0.6)	(0.1)	(4.3)	(22.6)
Other non-cash items	0.6	0.2	18.7	0.6
	5.0	5.4	41.3	17.3
Distributable cash	\$ 27.5	\$ 29.7	\$ 103.8	\$ 67.3
Per Stapled Unit amounts: <i>(in dollars)</i>				
Basic and diluted earnings available for distribution before provision for future income taxes per weighted average Stapled Unit	\$ 0.29	\$ 0.31	\$ 0.81	\$ 0.65
Basic and diluted distributable cash per weighted average Stapled Unit	\$ 0.35	\$ 0.38	\$ 1.34	\$ 0.87
Cash distributions paid per Stapled Unit	\$ 0.27	\$ 0.27	\$ 1.08	\$ 1.08

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

<i>(in millions of dollars)</i>	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
Cash flow from operations before changes in working capital	\$ (6.8)	\$ (0.6)	\$ (8.5)	\$ (34.5)
Add (deduct):				
Interest on Series A Subordinate Notes owned by unitholders	20.9	20.9	83.6	83.3
Proceeds from sale of property, plant and equipment	13.9	9.8	33.0	42.8
Additions to property, plant and equipment	(0.6)	(0.1)	(4.3)	(22.6)
Other non-cash items	0.1	(0.3)	—	(1.7)
	34.3	30.3	112.3	101.8
Distributable cash	\$ 27.5	\$ 29.7	\$ 103.8	\$ 67.3

Distributable cash includes consolidated net earnings (loss), plus interest expensed on Series A Subordinate Notes owned by unitholders, plus non-cash income taxes, plus depreciation, depletion and amortization, plus proceeds from the sale of property, plant and equipment net of their gain (loss) on sale, less additions to property, plant and equipment and, from time to time, adjustments for other items deemed appropriate by the Board of Directors. Earnings available for distribution is comprised of consolidated net earnings (loss) plus interest expensed on Series A Subordinate Notes. The Series A Subordinate Notes are owned by the unitholders and interest thereon is paid to the unitholders, therefore, earnings available for distribution to unitholders reflects earnings before this interest charge.

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

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

	2006	2005	2004	2003	2002	2001
<b>Distributable Cash</b> <i>(in millions of dollars)</i>						
First quarter	\$ 31.5	\$ 23.9	\$ 27.7	\$ 25.7	\$ 21.2	\$ 25.9
Second quarter	35.5	15.4	43.5	4.7	10.6	26.7
Third quarter	9.3	(1.7)	35.9	12.0	34.1	14.1
Fourth quarter	27.5	29.7	18.1	9.0	24.2	16.8
	\$ 103.8	\$ 67.3	\$ 125.2	\$ 51.4	\$ 90.1	\$ 83.5
<b>Distributable Cash per Stapled Unit</b> <sup>1</sup> <i>(in dollars)</i>						
First quarter	\$ 0.41	\$ 0.31	\$ 0.36	\$ 0.34	\$ 0.30	\$ 0.40
Second quarter	0.46	0.20	0.57	0.06	0.14	0.41
Third quarter	0.12	(0.02)	0.47	0.15	0.45	0.22
Fourth quarter	0.35	0.38	0.24	0.12	0.32	0.26
	\$ 1.34	\$ 0.87	\$ 1.64	\$ 0.67	\$ 1.21	\$ 1.29

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

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## Financial Highlights

Financial Highlights <i>(in millions of dollars)</i>	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
	Sales	\$ 110.6	\$ 132.8	\$ 478.1
Operating earnings	25.5	21.0	94.7	70.1
Operating earnings - % of sales	23.1%	15.8%	19.8%	15.3%
Pension plan annuitization	—	—	17.7	—
Termination of fibre supply agreement	—	—	—	15.0
EBITDA <sup>2</sup>	27.9	26.5	85.9	71.9
Income tax recovery	(13.4)	(31.6)	(38.2)	(41.6)
Net earnings	14.8	30.9	17.1	4.8
Distributable cash	\$ 27.5	\$ 29.7	\$ 103.8	\$ 67.3

### Quarterly Financial Highlights

Log sales for the three months ended December 31, 2006, were down compared to sales for the fourth quarter of 2005 due to weather related production curtailments during the third and fourth quarters of 2006. The increase in operating earnings as a percentage of sales in the fourth quarter was due to stronger pricing and a better end use sort mix compared to 2005 which had a higher proportion of lower-value hembal.

Average realizations on log sales for the quarter were \$96 per m<sup>3</sup> primarily due to stronger pricing, a better species and end use sort mix, and higher volumes to Japan compared to the same period in 2005. However, log sales volumes were lower at 644,000 m<sup>3</sup> primarily due to a lower opening log inventory resulting from prolonged harvesting curtailments in the third quarter due to the hot, dry weather and some early snowfalls that affected production during the fourth quarter. Earnings before interest, taxes, depreciation and amortization (EBITDA)<sup>2</sup> for the three months ended December 31, 2006, were \$27.9 million or \$0.36 per basic and diluted weighted average Stapled Unit compared to \$26.5 million or \$0.34 per basic and diluted weighted average Stapled Unit for the comparative period in 2005. The Company reported an income tax recovery of \$13.4 million for the three months ended December 31, 2006, representing a non-cash future income tax recovery. The Company generated net earnings for the three months ended December 31, 2006, of \$14.8 million, equating to basic and diluted net earnings of \$0.19 per weighted average common share compared to net earnings of \$30.9 million or basic and diluted net earnings of \$0.40 per weighted average common share for the comparative period in 2005.

### Year to Date Financial Highlights

The year over year strengthening of the operating margin primarily reflects higher average realizations on log and lumber sales, which were \$98 per m<sup>3</sup> and \$635 per mfbm, respectively, and an increase in lumber sales volumes to 184.6 mfbm, offset in part by a decrease in log sales volumes to 3.1 million m<sup>3</sup>, compared to the same period in 2005. A combination of improved log pricing and a richer end use sort mix during 2006 more than offset the adverse currency effects of a strong Canadian dollar, contributing to the higher sales realizations in the current year. Year-to-date results reflect a \$17.7 million non-cash pension expense related to the annuitization and transfer of certain pension plan obligations completed during the year. Year-to-date earnings results for 2005 reflect a \$15.0 million payment made in that period to terminate a fibre supply agreement. The Company reported an income tax recovery of \$38.2 million for the twelve months ended December 31, 2006, representing a non-cash future income tax recovery comprised primarily of a \$14.8 million recovery to reflect the effect of changes in Canadian federal income tax rates that were substantively

<sup>2</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 (loss) as determined in accordance with GAAP and EBITDA is provided in the supplemental information appended to this interim report.



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enacted during the second quarter of 2006, and a \$5.8 million recovery arising from the pension plan annuitization transaction, and a \$10.4 million recovery related to the utilization of non-capital tax losses.

Real estate proceeds for the year were \$32.9 million compared to \$13.9 million for 2005. 2005 proceeds from other assets included \$25.2 million related to equipment sales to TimberWest's contractors and \$3.7 million related to the timber reallocation agreement with the Province.

### **Highlights and Significant Transactions**

#### ***Pension Plan Annuitization***

During the year, the Company entered into an agreement with a financial institution to purchase annuities for all retirees in the Company's salaried employee defined benefit pension plans. \$90.7 million of pension obligations were transferred to the financial institution at a cost to the Company of \$1.1 million. In addition, the Company recorded a \$17.7 million non-cash pension expense in 2006 related to this transaction, representing the unamortized net actuarial loss associated with retiree pension obligations at the transaction date that would have otherwise been amortized over the expected life of the pension plan.

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

#### ***Countervailing and Antidumping Duty Refund***

During the fourth quarter, the Company received a net refund of \$3.4 million. The refund consisted of Countervailing and Antidumping duty refunds in the amount of \$3.0 million and accrued interest in the amount of \$0.4 million. Pursuant to the Softwood Lumber Products Export Charge Act, a charge of 18.06% in the amount of \$0.8 million was imposed on the total refund of \$4.2 million.

#### ***Cash Distribution***

On February 8, 2007, TimberWest announced a distribution of \$0.269 per Stapled Unit, payable April 15, 2007, to unitholders of record on April 1, 2007. From inception to December 31, 2006, the Company has generated distributable cash of \$767.9 million while, including the January 15, 2007 distribution of \$20.9 million, the Company has paid out \$733.7 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.

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## Operating Highlights

	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
<b>Log Sales</b> (in millions of dollars)				
Domestic	\$ 31.6	\$ 35.0	\$ 127.8	\$ 141.4
Export – Asia	25.5	31.1	127.6	115.0
Export – US	4.8	22.7	47.8	71.5
<b>Total log sales</b>	<b>\$ 61.9</b>	<b>\$ 88.8</b>	<b>\$ 303.2</b>	<b>\$ 327.9</b>
<b>Log Sales Realizations</b> (\$/m <sup>3</sup> )				
Domestic	83	69	79	72
Export – Asia	121	132	129	135
Export – US	91	91	97	90
	<b>96</b>	<b>90</b>	<b>98</b>	<b>91</b>
<b>Log Sales Volume</b> (thousand m <sup>3</sup> )				
Domestic	381.3	504.5	1,609.5	1,965.8
Export – Asia	209.9	234.8	985.2	853.3
Export – US	53.0	250.8	492.5	795.7
	<b>644.2</b>	<b>990.1</b>	<b>3,087.2</b>	<b>3,614.8</b>
<b>Log Sales Mix</b> (thousand m <sup>3</sup> )				
Fir	308.7	511.4	1,893.7	2,002.4
Hembal	221.5	325.9	662.9	1,013.5
Cedar	61.5	95.3	283.3	359.9
Other	52.5	57.5	247.3	239.0
	<b>644.2</b>	<b>990.1</b>	<b>3,087.2</b>	<b>3,614.8</b>
<b>Log Production Volume</b> (thousand m <sup>3</sup> )				
Public tenures	76.3	175.1	711.2	761.0
Private timberlands	742.3	617.2	2,723.9	2,871.7
	<b>818.6</b>	<b>792.3</b>	<b>3,435.1</b>	<b>3,632.7</b>

Log sales for the fourth quarter of 2006 were lower compared to the same period in 2005 due to lower levels of product available for sale as logging operations on the Company's private timberlands were curtailed due to severe weather during the third and fourth quarters. Pricing levels in the fourth quarter of 2006 were supported by both a lower supply of logs in many of the Company's market segments and a stronger sales mix. The operating margin from timberland operations averaged 23% of log sales for the fourth quarter of 2006, compared to 21% of log sales for the fourth quarter of 2005, a result that reflects the net effect of lower log sales volumes, higher average log sales realizations and higher costs.

The flexibility provided by TimberWest's private timberland asset base allowed the Company to take advantage of strong markets early in the first half of the year by increasing harvest levels. However, the volume gains realized in the first half of the year were offset by weather related production curtailments during the third and fourth quarters of 2006. Average log sales realizations for 2006 were stronger than 2005 due to a better end use sort mix and improved pricing. The Canadian dollar was approximately 7% stronger relative to the US dollar during 2006 compared to 2005, and continued to negatively affect realizations. However, a combination of improved log pricing and a richer end use sort mix during 2006 more than offset the currency effects and contributed to higher sales realizations in the current year period. The operating margin from timberland operations for the twelve months of 2006 averaged 30% of log sales, compared to

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26% of log sales for the comparative period in 2005. The improvement is attributed to higher log sales realizations, offset by higher input costs for logging contractors.

	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
<b>Sales by Product</b> <i>(in millions of dollars)</i>				
Lumber	\$ 29.5	\$ 28.1	\$ 117.3	\$ 92.2
Wood chips	\$ 3.2	\$ 3.0	\$ 12.9	\$ 10.9
<b>Sales Realizations</b>				
Lumber (\$/mfbm)	666	587	635	552
Wood Chips (\$/m <sup>3</sup> )	38	35	36	35
<b>Sales Volume</b>				
Lumber (million fbm)	44.3	47.9	184.6	166.9
Wood Chips (thousand m <sup>3</sup> )	82.8	86.6	361.7	310.3
<b>Lumber Production Volume</b> (million fbm)	41.5	44.1	183.4	167.6

Higher sales realizations in the fourth quarter and for the year ended 2006 reflect continued strength in demand from and short supply in Japan.

Production at the sawmill for the year 2006 was up approximately 9% compared to production in the same period of 2005, reflecting the effect of five weeks of market-related downtime taken during the second quarter of 2005. There was no downtime in 2006.

Wood chip sales for the three months ended December 31, 2006, compared to the same period in 2005 were higher due to a \$3/m<sup>3</sup> increase in average chip sales realizations. Wood chip sales for the year 2006 were higher reflecting greater chip volumes available for sale due to increased production at the sawmill, and by slightly higher average chip sales realizations.

	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
<b>Real Estate Sales</b> (in millions of dollars)	\$ 15.0	\$ 10.2	\$ 36.0	\$ 15.1
<b>Real Estate Net Proceeds</b> (in millions of dollars)	\$ 13.9	\$ 9.7	\$ 32.9	\$ 13.9
<b>Real Estate Net Proceeds</b> (\$/acre)	11,936	11,560	10,314	8,515

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<i>(in millions of dollars)</i>	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
<b>Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)*</b>				
<i>(in millions of dollars)</i>				
Net earnings	\$ 14.8	\$ 30.9	\$ 17.1	\$ 4.8
Add (deduct):				
Interest on Series A Subordinate Notes paid to unitholders	20.9	20.9	83.6	83.3
Interest on long-term debt	0.2	4.0	11.2	14.8
Interest on short-term debt	3.4	—	3.4	1.1
Income tax recovery	(13.4)	(31.6)	(38.2)	(41.6)
Depreciation, depletion and amortization	1.8	2.2	8.2	8.8
Amortization of deferred financing costs	0.2	0.1	0.6	0.7
<b>EBITDA</b>	<b>\$ 27.9</b>	<b>\$ 26.5</b>	<b>\$ 85.9</b>	<b>\$ 71.9</b>

\* 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.

## Financial Position

<b>Summary of Financial Position</b>	<b>As at December 31, 2006</b>	<b>As at December 31, 2005</b>
<i>(in millions of dollars)</i>		
Cash and cash equivalents	\$ 9.3	\$ 3.0
Current assets	83.1	88.8
Current liabilities	253.8	51.0
Current liabilities (excluding short-term debt)	58.8	51.0
Long-term debt	—	232.0
Long-term liabilities	189.2	216.7
Series A Subordinate notes owned by unitholders	697.0	695.7
Unitholder's equity	241.6	223.7

Cash and cash equivalents increased at December 31, 2006, reflecting strong year-to-date cash flows from operations and the sale of higher and better use properties. Trade accounts receivable decreased to \$16.9 million at December 31, 2006, down from \$23.9 million at the end of 2005, reflecting the effect of a 17% decrease in sales during the fourth quarter of 2006, compared to the same period in 2005. Inventory was \$49.0 million at December 31, 2006, comparable to \$48.2 million at the end of 2005. Log inventory was \$40.5 million at the end of 2006, compared to \$39.3 million at the end of 2005, the increase reflecting higher-value inventory at the end of 2006 compared to 2005. Lumber inventory was \$7.3 million at the end of 2006 compared to \$7.5 million at December 31, 2005. This decrease reflects an 8% decrease in year-end volumes offset by higher value inventory at the end of 2006. Prepaid expenses and other current assets were \$5.6 million at December 31, 2006, compared to \$11.2 million at the end of 2005. This decrease is primarily due to the higher December 31, 2005 balance, which included higher amounts, related to real estate activity in the fourth quarter of 2005, including amounts receivable on transactions that had closed before the end of 2005.

Property, plant and equipment were \$1,296.3 million as at December 31, 2006, \$22.1 million less than as at December 31, 2005. This decrease primarily reflects the sale of property, plant and equipment with a net book value of \$18.1 million during 2006, including higher and better use properties, as well as a provision for depreciation of capital assets of \$8.3 million recorded during this period. These items were offset in part by year to date capital additions of \$4.3 million, comprised primarily of a new log inventory management system and logging roads.

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Other assets were \$2.2 million at December 31, 2006, down from the balance of \$11.9 million at December 31, 2005. Of note is the elimination of an \$8.3 million prepaid pension benefit asset from other assets as a result of the transfer of pension obligations to financial institutions on the annuitization and transfer of certain pension obligations that were completed in the second and third quarters of 2006 (see Highlights and Significant Transactions – *Pension Plan Annuitization*).

Current liabilities as at December 31, 2006, includes the \$195.0 million aggregate principle amount of 7% unsecured senior debentures, which were reclassified from long-term to current liabilities in the fourth quarter 2006. Excluding the debentures, current liabilities at the end of 2006 were \$58.8 million. This variance can be attributed to a \$7.8 million increase in accounts payable and accrued liabilities primarily attributed to higher trade payables and invoice accruals due to higher logging production in December 2006 compared to December 31, 2005.

As at December 31, 2006, the Company had no borrowings on its available credit facilities and had commitments of \$16.8 million relating to outstanding letters of credit, including \$16.2 million issued under its demand bank guarantee facility and \$0.6 million issued under its \$100.0 million long-term unsecured revolving facility.

As at December 31, 2006 the Company had no long-term financial liabilities, as the \$195.0 million aggregate principal amount of 7.0% unsecured senior debentures due October 1, 2007, were reclassified from long-term to current liabilities. The Company intends to refinance these bonds prior to October 1, 2007.

Other long-term liabilities as at December 31, 2006, included a silviculture liability of \$3.6 million, a \$39.2 million liability relating to employee future benefits and a future income tax liability of \$146.4 million. The silviculture liability at December 31, 2006, is comparable to the balance of \$3.2 million as at December 31, 2005. The \$10.6 million increase in employee future benefits from the balance of \$28.6 million at December 31, 2005, can be attributed to a reclassification of the liability for certain pension obligations as a result of the annuitization of certain pension obligations (see Highlights and Significant Transactions – *Pension Plan Annuitization*). The \$38.5 million decrease in the liability for future income taxes from the balance of \$184.9 million at December 31, 2005, is primarily attributable to a \$14.8 million future income tax recovery to reflect the effects of changes in Canadian federal income tax rates that were substantively enacted during the year, \$5.8 million future income tax recovery arising from the pension plan annuitization transaction, and a \$10.4 million recovery related to tax planning strategies.

The Series A Subordinate Note component of the Company's Stapled Unit is presented as a liability on the Company's consolidated balance sheets. As at December 31, 2006, the Series A Subordinate Note liability was \$697.0 million.

During the quarter ended December 31, 2006, options to purchase 52,166 Stapled Units were exercised for proceeds of \$0.7 million and 11,863 options were cancelled. During the twelve months ended December 31, 2006, 245,238 Stapled Unit options were granted, options to purchase 147,683 Stapled Units were exercised for proceeds of \$1.9 million and 17,500 options were cancelled. As at February 8, 2007, the Company had 930,120 granted and outstanding Stapled Unit option awards and 77,640,668 issued and outstanding Stapled Units.

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## Cash Flow and Liquidity

Selected Cash Flow Items <i>(in millions of dollars)</i>	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
<b>Cash provided by (used in):</b>				
<b>Operating activities:</b>				
Cash provided by (used in) operations before changes in non-cash working capital	(6.8)	(0.6)	(8.5)	(34.5)
Changes in non-cash working capital	(8.6)	4.0	19.6	(7.1)
	(15.4)	3.4	11.1	(41.6)
<b>Financing activities:</b>				
Issuance of Stapled Units on exercise of options	0.7	2.7	1.9	7.1
Credit facilities	—	(13.0)	(37.0)	15.0
	0.7	(10.3)	(35.1)	22.1
<b>Investing activities:</b>				
Proceeds from sale of property, plant and equipment	13.9	9.8	33.0	42.8
Additions to property, plant and equipment	(0.6)	(0.1)	(4.3)	(22.6)
Other assets	0.4	0.2	1.6	0.7
	13.7	9.9	30.3	20.9
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1.0)</b>	<b>3.0</b>	<b>6.3</b>	<b>1.4</b>

During the three months ended December 31, 2006, the Company issued 52,166 Stapled Units on the exercise of Stapled Unit options for net proceeds of \$0.7 million, compared to the issuance of 212,490 Stapled Units on the exercise of Stapled Unit options for net proceeds of \$2.7 million in the comparative period of 2005. During the fourth quarter of 2006, there were no borrowings on available credit facilities, whereas \$13.0 million was applied to reduce amounts borrowed on available credit facilities in the comparative period in 2005.

For the year ended December 31, 2006, the Company issued 147,683 Stapled Units for net proceeds of \$1.9 million on the exercise of Stapled Unit options, compared to the issuance of 580,554 Stapled Units for net proceeds of \$7.1 million on the exercise of Stapled Unit options in the comparative period in 2005. In 2006, \$37.0 million was applied to reduce amounts borrowed on available credit facilities as compared to an increase to borrowings of \$15.0 million in 2005.

In the fourth quarter of 2006, the Company received net proceeds of \$13.9 million from the sale of property, plant and equipment, primarily from the sale of higher use properties, and incurred \$0.6 million for capital expenditures, primarily for the construction of logging roads.

During 2006, the Company received net proceeds of \$33.0 million from the sale of property, plant and equipment, primarily from the sale of higher use properties, and incurred \$4.3 million for capital expenditures, primarily for the construction of logging roads and for the implementation of a new log inventory management system. Comparative figures for 2005 reflect transactions related to the business transformation initiative completed during that period, including \$21.0 million for the buy-out of leases on Company-operated logging equipment which was subsequently sold to the Company's new long-term contractors, with the Company receiving approximately \$25.2 million in proceeds from the sale of both leased and Company-owned logging equipment. In addition, proceeds from the sale of property, plant and equipment for the comparative period of 2005 included \$3.7 million in proceeds received in connection with the timber reallocation agreement with the Province that was finalized in that year.

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## TIMBERWEST FOREST CORP.

As at December 31, 2006, TimberWest's total debt<sup>3</sup> outstanding was \$195.0 million compared to total debt outstanding of \$232.0 million as at December 31, 2005. The Company's consolidated debt-to-total capitalization ratio<sup>3</sup> as at December 31, 2006 was 17:83, compared to 20:80 as at December 31, 2005.

Total debt facilities available to the Company as at December 31, 2006, were \$386.3 million, comprised of \$10.0 million available under a demand operating credit facility, \$16.3 million available under a demand bank guarantee facility, \$65.0 million available under a revolving facility due July 7, 2010, \$100.0 million available under a revolving facility due July 27, 2010 and \$195.0 million of 7.0% debentures maturing on October 1, 2007. As at December 31, 2006, the Company had commitments of \$16.8 million relating to outstanding letters of credit issued to secure various obligations of the Company, including \$16.2 million issued under its demand bank guarantee facility and \$0.6 million issued under its \$100.0 million long-term unsecured revolving facility.

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<sup>3</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. As the Company's Series A Subordinate Notes trade only as part of the Company's equity instrument, the Stapled Unit, they are not included in the Company's definition of debt. Management believes that the presentation of these measures will enhance an investor's understanding of the Company's financial resources and capital structure.

# TIMBERWEST FOREST CORP.

## Quarterly Financial Information

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

<i>(in millions of dollars, except per common share and per Stapled Unit amounts)</i>	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sales	\$ 98.6	\$ 107.6	\$ 119.2	\$ 132.8	\$ 125.7	\$ 145.0	\$ 96.8	\$ 110.6
Operating earnings	\$ 17.3	\$ 17.8	\$ 14.0	\$ 21.0	\$ 25.3	\$ 32.6	\$ 11.3	\$ 25.5
Net earnings (loss)	\$ (2.4)	\$ (6.7)	\$ (17.0)	\$ 30.9	\$ 2.9	\$ 12.2	\$ (12.8)	\$ 14.8
Earnings available for distribution	\$ 18.4	\$ 14.1	\$ 3.8	\$ 51.8	\$ 23.8	\$ 33.1	\$ 8.1	\$ 35.7
Earnings (loss) available for distribution before provision for future income taxes	\$ 19.6	\$ 13.0	\$ (6.9)	\$ 24.3	\$ 21.2	\$ 11.5	\$ 7.3	\$ 22.5
Distributable cash	\$ 23.9	\$ 15.4	\$ (1.7)	\$ 29.7	\$ 31.5	\$ 35.5	\$ 9.3	\$ 27.5
Distributions paid	\$ 20.7	\$ 20.8	\$ 20.8	\$ 20.8	\$ 20.9	\$ 20.9	\$ 20.9	\$ 20.9
<i>\$ per common share</i> <sup>4</sup>								
Basic net earnings (loss)	\$ (0.03)	\$ (0.09)	\$ (0.22)	\$ 0.40	\$ 0.04	\$ 0.16	\$ (0.17)	\$ 0.19
Diluted net earnings (loss)	\$ (0.03)	\$ (0.09)	\$ (0.22)	\$ 0.40	\$ 0.04	\$ 0.16	\$ (0.16)	\$ 0.19
<i>\$ per Stapled Unit</i> <sup>4</sup>								
Basic and diluted earnings available for distribution	\$ 0.24	\$ 0.18	\$ 0.05	\$ 0.67	\$ 0.31	\$ 0.43	\$ 0.10	\$ 0.46
Basic and diluted earnings (loss) available for distribution before provision for future income taxes	\$ 0.25	\$ 0.17	\$ (0.09)	\$ 0.31	\$ 0.27	\$ 0.15	\$ 0.09	\$ 0.29
Basic and diluted distributable cash	\$ 0.31	\$ 0.20	\$ (0.02)	\$ 0.38	\$ 0.41	\$ 0.46	\$ 0.12	\$ 0.35
Distributions paid	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27	\$ 0.27

*The statements which are not historical facts contained in this report are forward-looking statements that involve risks and uncertainties. TimberWest's actual results could differ materially from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, general economic conditions, variations in TimberWest's product prices and changes in commodity prices generally, changes in market conditions for TimberWest's forest products, changes in real estate market conditions in the areas where TimberWest's higher use properties are located, actions of competitors, interest rate and foreign currency fluctuations, regulatory, harvesting fee and trade policy changes and other actions by governmental authorities, the ability to implement business strategies and pursue business opportunities, labour relations, weather conditions, forest fires, insect infestation, disease and other natural phenomena and other risks and uncertainties described in TimberWest's public filings with securities regulatory authorities.*

<sup>4</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.

## 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	
	2006	2005	2006	2005
Sales	\$ 110.6	\$ 132.8	\$ 478.1	\$ 458.2
Operating costs and expenses:				
Cost of products sold	82.8	106.3	364.1	365.1
Countervailing and antidumping duty refund (note 3)	(3.0)	—	(3.0)	—
Depreciation, depletion and amortization	1.8	2.2	8.2	8.8
Selling, administrative and other	3.5	3.3	14.1	14.2
	85.1	111.8	383.4	388.1
Operating earnings	25.5	21.0	94.7	70.1
Interest expense:				
Series A Subordinate Notes owned by unitholders	20.9	20.9	83.6	83.3
Long-term debt	0.2	4.0	11.2	14.8
Short-term debt	3.4	—	3.4	1.1
	24.5	24.9	98.2	99.2
Amortization of deferred financing costs	0.2	0.1	0.6	0.7
Other income	(0.6)	(3.3)	(0.7)	(8.0)
Pension plan annuitization (note 4)	—	—	17.7	—
Termination of fibre supply agreement (note 5)	—	—	—	15.0
	24.1	21.7	115.8	106.9
Earnings (loss) before income taxes	1.4	(0.7)	(21.1)	(36.8)
Income tax recovery (note 6)	(13.4)	(31.6)	(38.2)	(41.6)
Net earnings	\$ 14.8	\$ 30.9	\$ 17.1	\$ 4.8
<i>Earnings per common share (note 7)</i>				
<i>Basic</i>	\$ 0.19	\$ 0.40	\$ 0.22	\$ 0.06
<i>Diluted</i>	\$ 0.19	\$ 0.40	\$ 0.22	\$ 0.06

## Consolidated Statements of Retained Earnings

(in millions of dollars)  
Unaudited

	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
Retained earnings, beginning of period, as previously reported	\$ 35.5	\$ 2.3	\$ 33.2	\$ 28.4
Change in accounting policy for stock-based compensation (note 2)	(0.2)	—	(0.2)	—
Retained earnings, beginning of period, as restated	35.3	2.3	33.0	28.4
Net earnings for the period	14.8	30.9	17.1	4.8
Retained earnings, end of period	\$ 50.1	\$ 33.2	\$ 50.1	\$ 33.2

See accompanying notes to unaudited interim consolidated financial statements.

# TIMBERWEST FOREST CORP.

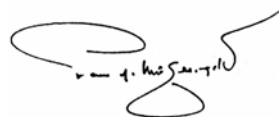
## Consolidated Balance Sheets

(in millions of dollars)

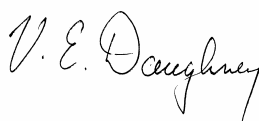
	As at December 31, 2006 <i>Unaudited</i>	As at December 31, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 9.3	\$ 3.0
Accounts receivable	16.9	23.9
Inventories	49.0	48.2
Prepaid expenses and other current assets	5.6	11.2
Future income taxes	2.3	2.5
	83.1	88.8
Property, plant and equipment, net (note 8)	1,296.3	1,318.4
Other assets (note 9)	2.2	11.9
	\$ 1,381.6	\$ 1,419.1
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities:		
Debentures	\$ 195.0	\$ —
Accounts payable and accrued liabilities	37.9	30.1
Distribution payable	20.9	20.9
	253.8	51.0
Credit facilities (note 10)	—	37.0
Debentures	—	195.0
Long-term silviculture liability	3.6	3.2
Employee future benefits (note 11)	39.2	28.6
Future income taxes	146.4	184.9
	443.0	499.7
Series A Subordinate Notes owned by unitholders (note 12)	697.0	695.7
	1,140.0	1,195.4
Unitholders' equity:		
Share capital, consisting of common and preferred shares (note 12)	190.4	189.8
Contributed surplus	1.1	0.7
Retained earnings	50.1	33.2
	241.6	223.7
	\$ 1,381.6	\$ 1,419.1

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	
	2006	2005	2006	2005
<b>Cash provided by (used in):</b>				
<b>Operating activities:</b>				
Net earnings	\$ 14.8	\$ 30.9	\$ 17.1	\$ 4.8
Items not involving cash:				
Depreciation, depletion and amortization	2.0	2.3	8.8	9.5
(Gain) loss on sale of property, plant and equipment	(10.9)	(6.8)	(14.9)	(13.0)
Future income tax recovery	(13.2)	(27.5)	(38.2)	(38.1)
Other non-cash items	0.5	0.5	18.7	2.3
	(6.8)	(0.6)	(8.5)	(34.5)
Changes in non-cash working capital:				
Accounts receivable	(3.8)	(2.7)	7.0	(9.2)
Inventories	(6.6)	21.7	(0.8)	14.0
Prepaid expenses and other	3.1	1.2	5.6	(6.7)
Accounts payable and accrued liabilities	(1.3)	(16.3)	7.8	(5.4)
Distribution payable	—	0.1	—	0.2
	(15.4)	3.4	11.1	(41.6)
<b>Financing activities:</b>				
Issuance of Stapled Units on exercise of options:				
Series A Subordinate Notes	0.4	1.8	1.3	5.2
Share capital	0.3	0.9	0.6	1.9
	0.7	2.7	1.9	7.1
Demand credit facility	—	(0.5)	—	—
Revolving credit facilities	—	(12.5)	(37.0)	15.0
	0.7	(10.3)	(35.1)	22.1
<b>Investing activities:</b>				
Proceeds from sale of property, plant and equipment	13.9	9.8	33.0	42.8
Additions to property, plant and equipment	(0.6)	(0.1)	(4.3)	(22.6)
Other assets	0.4	0.2	1.6	0.7
	13.7	9.9	30.3	20.9
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(1.0)</b>	<b>3.0</b>	<b>6.3</b>	<b>1.4</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>10.3</b>	<b>—</b>	<b>3.0</b>	<b>1.6</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 9.3</b>	<b>\$ 3.0</b>	<b>\$ 9.3</b>	<b>\$ 3.0</b>
<b>Supplemental information:</b>				
Interest on Series A Subordinate Notes paid to unitholders	\$ 20.9	\$ 20.8	\$ 83.6	\$ 83.1
Other interest paid	\$ 7.1	\$ 7.4	\$ 14.6	\$ 16.0
Income taxes paid	\$ (0.2)	\$ 0.1	\$ —	\$ 0.6

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, 2006 and 2005

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

### 1. Significant Accounting Policies

The accompanying unaudited interim consolidated financial statements include the accounts of TimberWest Forest Corp. and its subsidiaries ("the Company"), have been prepared in accordance with Canadian generally accepted accounting principles and are expressed in Canadian dollars. Not all disclosures required by Canadian generally accepted accounting principles for annual financial statements are presented and, accordingly, these interim consolidated financial statements should be read in conjunction with the Company's most recent annual consolidated financial statements. These interim consolidated financial statements follow the same accounting policies and methods of application used in the Company's audited annual consolidated financial statements of December 31, 2005, except for the accounting policy change as described in note 2.

### 2. Change in Accounting Policy

Prior to October 1, 2006, the Company recognized compensation cost for stock-based compensation awards to all employees over the vesting period of the awards. Effective October 1, 2006, the Company changed its policy of accounting for awards and now recognizes the compensation cost for employees eligible to retire at the grant date rather than over the vesting period. For employees who become eligible for retirement during the vesting period, compensation cost is recognized over the period from the grant date to the date of eligibility for retirement.

The Company made this change in accounting policy on a retroactive basis but prior years have not been restated. The cumulative adjustment to the opening balance of retained earnings is a decrease of \$0.2 million. In 2006, the effect on compensation was nil, deferred stock based compensation costs decreased \$0.1 million and contributed surplus increased \$0.1 million.

### 3. Countervailing and Antidumping Duty Refund

During the fourth quarter, the Company received a net refund of \$3.4 million. The refund consisted of Countervailing and Antidumping duty refunds in the amount of \$3.0 million and accrued interest in the amount of \$0.4 million. Pursuant to the Softwood Lumber Products Export Charge Act, a charge of 18.06% in the amount of \$0.8 million was imposed on the total refund of \$4.2 million.

### 4. Pension Plan Annuitization

In the second quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for all retirees in the Company's salaried employee defined benefit pension plans. Effective April 15, 2006, \$89.7 million of pension obligations were transferred to the financial institution at a cost to the Company of \$1.1 million. In addition, the Company recorded a \$17.2 million non-cash pension expense in the second quarter of 2006 related to this transaction, representing the unamortized net actuarial loss associated with retiree pension obligations at the transaction date that would have otherwise been amortized over the expected life of the pension plan (see notes 6 and 11).

In the third quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for members of one of the Company's remaining small defined benefit pension plans. Effective July 14, 2006, approximately \$1.0 million of pension obligations and \$1.4 million of pension assets were transferred to the financial institution. As this pension plan was in a surplus position at the time of this transaction there was no cash cost to the Company, however, the Company recorded a \$0.5 million non-cash pension expense in the third quarter of 2006, representing the settlement loss on finalization of this transaction (see note 11).

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2006 and 2005

### 5. Termination of Fibre Supply Agreement

In the third quarter of 2005, the Company reached an agreement to terminate a fibre supply agreement with a customer for payment of \$15.0 million. The fibre supply agreement was originally entered into in 1997 and required the Company to offer the customer, in perpetuity, an annual volume of 330,000 m<sup>3</sup> of sawlogs at domestic market prices.

### 6. Income Taxes

	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
Current income tax expense				
Large corporation tax	\$ (0.2)	\$ —	\$ —	\$ 0.6
Federal income tax recovery	—	(4.1)	—	(4.1)
	(0.2)	(4.1)	—	(3.5)
Future income tax recovery	(13.2)	(27.5)	(38.2)	(38.1)
	\$ (13.4)	\$ (31.6)	\$ (38.2)	\$ (41.6)

In the second quarter of 2006, a number of changes to Canadian federal income tax rates were substantively enacted, including: elimination of the Large Corporations Tax (LCT), effective January 1, 2006; elimination of the 4% surtax effective January 1, 2008; and the reduction of the federal general corporate income tax rate to 20.5% for 2008, 20% for 2009, and 19% for 2010 and subsequent years. These changes will result in a reduction in the combined federal and provincial statutory corporate income tax rate from its present rate of 34.12% to 32.5% for 2008, 32.0% for 2009, and 31.0% for 2010 and subsequent years. These rate changes resulted in a future income tax recovery of \$14.8 million for the year ended December 31, 2006.

In the second quarter of 2006, the Company entered into an agreement with a financial institution to purchase annuities for all retirees in the Company's salaried employee defined benefit pension plans (see note 11). As a result of this transaction, the Company's future income tax liability was reduced by \$5.8 million.

Prior to the elimination of the LCT, the Company has paid installments in the amount of \$0.2 million, and at December 31, 2006 the Company had received refunds of the paid installments.

In the fourth quarter, the Company utilized non-capital tax losses, for which a full valuation allowance had been previously provided for accounting purposes, by recognizing unrealized gains on certain assets for tax purposes. As a result of these activities, the Company recorded a \$10.4 million (2005 - \$16.1 million) future income tax recovery.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2006 and 2005

### 7. Earnings per Share

	Three months ended December 31		Twelve months ended December 31	
	2006	2005	2006	2005
Net earnings	\$ 14.8	\$ 30.9	\$ 17.1	\$ 4.8
Basic weighted average number of common shares	77,605,496	77,398,008	77,544,968	77,207,309
Incremental common shares from potential exercise of options	79,041	98,492	73,526	108,130
Diluted weighted average number of common shares	77,684,537	77,496,500	77,618,494	77,315,439
Basic net earnings per common share	\$ 0.19	\$ 0.40	\$ 0.22	\$ 0.06
Diluted net earnings per common share	\$ 0.19	\$ 0.40	\$ 0.22	\$ 0.06

### 8. Property, Plant and Equipment

Property, plant and equipment at December 31, 2006, includes private timberlands with a carrying value of \$1,214.9 million. This amount includes a valuation increase adjustment of \$389.8 million recorded in the year ended December 31, 2000 resulting from the adoption of Section 3465 – *Income Taxes* of the CICA Handbook, which was mandatory for fiscal years ending on or after January 1, 2000.

### 9. Other Assets

	As at December 31, 2006	As at December 31, 2005
Deferred debt issue costs	\$ 0.8	\$ 1.4
Receivable on sale of property, plant and equipment	0.5	0.5
Other	0.9	1.7
Prepaid pension benefits (note 11)	–	8.3
	\$ 2.2	\$ 11.9

### 10. Credit Facilities

As at December 31, 2006, the Company had no borrowings on available credit facilities and had commitments of \$16.8 million relating to outstanding letters of credit, including \$16.2 million issued under its demand bank guarantee facility and \$0.6 million issued under its \$100.0 million long-term unsecured revolving facility.

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2006 and 2005

### 11. Employee Future Benefits

	As at December 31, 2006	As at December 31, 2005
Pension benefits	\$ 8.4	\$ —
Non-pension post-retirement benefits	30.8	28.6
	<b>\$ 39.2</b>	<b>\$ 28.6</b>

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

As at December 31, 2005, the Company had a prepaid pension asset of \$8.3 million. In April 2006, the Company recorded a \$17.2 million non-cash unamortized actuarial loss on the purchase of annuities for all retirees in the Company's salaried defined benefit pension plans. The reduction in the total pension asset on annuitization has resulted in a pension benefit obligation of \$8.4 million.

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

	As at December 31, 2006	As at December 31, 2005
Fair value of plan assets	\$ 6.7	\$ 97.4
Accrued benefit obligation	17.7	106.4
Excess of accrued benefit obligation over plan assets	(11.0)	(9.0)
Unamortized net actuarial loss	2.6	17.3
Net asset (accrued liability)	<b>\$ (8.4)</b>	<b>\$ 8.3</b>

For the three months ended December 31, 2006, the Company recorded an expense of \$0.5 million for pension benefit costs (2005 – \$0.8 million), and made cash payments of \$0.1 million to fund current and future service costs (2005 – \$0.7 million). For the twelve months ended December 31, 2006, the Company recorded an expense of \$19.8 million for pension benefit costs (2005 – \$2.5 million), including a \$17.7 million non-cash cost related to the annuitization transactions completed in the second and third quarters (see note 4), and made cash payments of \$3.2 million to fund current and future service costs (2005 – \$3.3 million), including \$0.2 million (2005 – \$0.4 million) for required contributions under the DB Plans, \$0.1 million (2005 – \$1.2 million) to fund the deficit in the DB Plans, \$0.9 million (2005 – \$0.8 million) for benefit payments relating to unfunded DB Plans, \$0.9 million (2005 – \$0.9 million) for required contributions under the DC Plan and \$1.1 million (2005 – nil) to fund the settlement of the DB plans.

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, 2006, the Company recorded an expense of \$1.0 million for non-pension benefit costs (2005 – \$0.9 million) and made cash payments of \$0.4 million to fund current benefit costs (2005 – \$0.6 million). For the twelve months ended December 31, 2006, the Company recorded an expense of \$4.0 million for non-pension benefit costs (2005 – \$3.6 million) and made cash payments of \$1.8 million to fund current benefit costs (2005 – \$2.0 million).

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2006 and 2005

### 12. Stapled Units

	Number	Stapled Unit Components		Total
		Series A Subordinate Notes	Share Capital (consisting of common and preferred shares)	
Twelve months ended December 31, 2005:				
Balance, December 31, 2004	76,907,017	\$ 690.5	\$ 187.8	\$ 878.3
Issuance of Stapled Units on exercise of options	580,554	5.2	2.0	7.2
<b>Balance, December 31, 2005</b>	<b>77,487,571</b>	<b>\$ 695.7</b>	<b>\$ 189.8</b>	<b>\$ 885.5</b>
<b>Twelve months ended December 31, 2006:</b>				
Balance, December 31, 2005	77,487,571	\$ 695.7	\$ 189.8	\$ 885.5
Issuance of Stapled Units on exercise of options	<b>147,683</b>	<b>1.3</b>	<b>0.6</b>	<b>1.9</b>
<b>Balance, December 31, 2006</b>	<b>77,635,254</b>	<b>\$ 697.0</b>	<b>\$ 190.4</b>	<b>\$ 887.4</b>

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

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

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

# TIMBERWEST FOREST CORP.

## Notes to Unaudited Interim Consolidated Financial Statements

For the three and twelve months ended December 31, 2006 and 2005

### 13. Stock-based Compensation Plans

Under the Company's Stapled Unit Option Plan, the Company may grant options for the purchase of Stapled Units to directors, officers or employees who are in active service or employment of the Company or of any of its subsidiaries. In the three months ended December 31, 2006, no Stapled Unit options were granted (2005 – nil). In the twelve months ended December 31, 2006, 245,238 Stapled Unit options were granted at an average exercise price of \$13.94 (2005 – 348,998 Stapled Unit options were granted at an average exercise price of \$15.79).

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

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

The compensation cost for the 245,238 Stapled Unit options granted between January 1, 2006 and December 31, 2006 is \$226,000 (2005 – 348,998 Stapled Unit options were granted with a compensation cost of \$454,900). The compensation cost of Stapled Unit option awards is amortized against earnings over the three-year vesting period of the underlying options and an expense of \$53,000 and \$277,000 has been recognized in net earnings for the three and twelve month periods ended December 31, 2006, respectively, (2005 – \$50,000 and \$411,000 – restated (see note 2), respectively,) for option awards made in fiscal 2003 through 2006, with a corresponding credit to contributed surplus.

Under the Company's Distribution Equivalent Plan, the Company awards Stapled Unit option holders an amount equal to actual distributions paid on the Company's Stapled Units. Awards granted under the Distribution Equivalent Plan vest under the same terms that apply to the corresponding options and can only be exercised at the time of exercise of the corresponding options. The Company applies the principles of the fair value-based method of accounting for stock-based compensation to awards granted under this plan. Awards are accrued on a basis equal to actual distributions paid on the Company's issued and outstanding Stapled Units and are charged to earnings as the underlying Stapled Unit options vest. For the three months ended December 31, 2006, \$0.2 million has been accrued for awards granted under this plan (2005 – \$0.3 million) and \$0.3 million has been amortized against earnings for the quarter (2005 – \$0.3 million). For the twelve months ended December 31, 2006, \$1.0 million has been accrued for awards granted under this plan (2005 – \$1.1 million) and \$1.0 million has been amortized against earnings for this period (2005 – \$1.1 million).

In the three months ended December 31, 2006, a total of 52,166 Stapled Unit options with an average exercise price of \$12.40 were exercised and 11,863 Stapled Unit options with an average exercise price of \$14.52 were cancelled (2005 – 212,490 Stapled Unit options with an average exercise price of \$12.75 were exercised). In the twelve months ended December 31, 2006, a total of 147,683 Stapled Unit options with an average exercise price of \$12.52 were exercised and 17,500 Stapled Unit options with an average exercise price of \$14.93 were cancelled (2005 – 580,554 Stapled Unit options with an average exercise price of \$12.17 were exercised and 70,543 Stapled Unit options with an average exercise price of \$14.33 were cancelled).

### 14. 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	
	2006	2005	2006	2005
<b>Sales by Product</b> <i>(in millions of dollars)</i>				
Log sales				
Domestic	\$ 31.6	\$ 35.0	\$ 127.8	\$ 141.4
Export – Asia	25.5	31.1	127.6	115.0
Export – US	4.8	22.7	47.8	71.5
Total log sales	61.9	88.8	303.2	327.9
Lumber	29.5	28.1	117.3	92.2
Wood chips and other	4.2	5.7	21.6	23.0
Real estate	15.0	10.2	36.0	15.1
	\$ 110.6	\$ 132.8	\$ 478.1	\$ 458.2
<b>Sales Volume</b>				
Logs ( <i>thousand m<sup>3</sup></i> )				
Domestic	381.3	504.5	1,609.5	1,965.8
Export – Asia	209.9	234.8	985.2	853.3
Export – US	53.0	250.8	492.5	795.7
	644.2	990.1	3,087.2	3,614.8
Lumber ( <i>million fbm</i> )	44.3	47.9	184.6	166.9
<b>Log Sales Mix (<i>thousand m<sup>3</sup></i>)</b>				
Fir	308.7	511.4	1,893.7	2,002.4
Hembal	221.5	325.9	662.9	1,013.5
Cedar	61.5	95.3	283.3	359.9
Other	52.5	57.5	247.3	239.0
	644.2	990.1	3,087.2	3,614.8
<b>Production Volume</b>				
Logs ( <i>thousand m<sup>3</sup></i> )				
Public tenures	76.3	175.1	711.2	761.0
Private timberlands	742.3	617.2	2,723.9	2,871.7
	818.6	792.3	3,435.1	3,632.7
Lumber ( <i>million fbm</i> )	41.5	44.1	183.4	167.6
<b>Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)*</b> <i>(in millions of dollars)</i>				
Net earnings	\$ 14.8	\$ 30.9	\$ 17.1	\$ 4.8
Add (deduct):				
Interest on Series A Subordinate Notes paid to unitholders	20.9	20.9	83.6	83.3
Interest on long-term debt	0.2	4.0	11.2	14.8
Interest on short-term debt	3.4	–	3.4	1.1
Income tax recovery	(13.4)	(31.6)	(38.2)	(41.6)
Depreciation, depletion and amortization	1.8	2.2	8.2	8.8
Amortization of deferred financing costs	0.2	0.1	0.6	0.7
EBITDA	\$ 27.9	\$ 26.5	\$ 85.9	\$ 71.9

\* EBITDA does not have a standardized meaning prescribed by Canadian generally accepted accounting principles and may not be comparable to similar measures presented by other companies. Management believes that the presentation of this measure will enhance an investor's understanding of the Company's operating performance.

# TIMBERWEST FOREST CORP.

## About TimberWest

TimberWest Forest Corp. is uniquely positioned as the largest owner of private forest lands in western Canada. The Company owns in fee simple approximately 334,000 hectares or 825,000 acres of private timberland that, over the previous five years, have provided an annual average harvest of 2.594 million m<sup>3</sup> of logs and have an approximate annual growth rate of 8.0 m<sup>3</sup> per hectare per year on the productive land base. These timberlands are located on Vancouver Island and the majority of the land base supports the growth of Douglas fir, a premium tree species sought after for structural purposes. TimberWest runs fully-contracted harvesting operations. With almost 80% of the Company's annual private land logging now being done in second-growth stands, TimberWest leads the Coastal industry in the growing and harvesting of second-growth timber.

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

TimberWest also owns renewable Crown harvest rights to 0.7 million m<sup>3</sup> of logs per year and operates a sawmill located near Campbell River, BC.

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

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

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

