

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Operations Review

THE FOLLOWING DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS AND NOTES THERETO INCLUDED IN THIS ANNUAL REPORT.

### LUMBER

The operating earnings from lumber were \$77.4 million (1997 - \$168.7 million) on external sales of \$668.6 million (1997 - \$811.2 million). Cash provided by operating activities was \$151.8 million (1997 - \$194.3 million). The decrease in operating earnings resulted primarily from reduced mill nets of approximately U.S. \$63 per Mfbm on average from 1997 levels. The reduction in mill nets was partially offset by the weaker Canadian dollar. Higher lumber recovery and lower log costs combined to reduce overall costs.

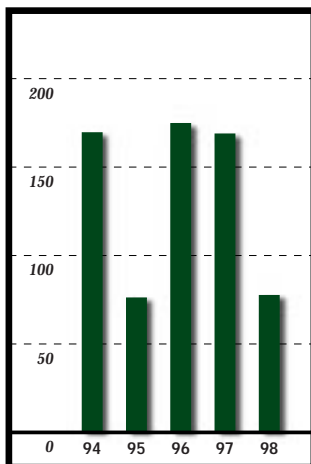
West Fraser's lumber operations continued to perform well under difficult circumstances during 1998. West Fraser's B.C. mills took market related downtime in 1998. In spite of this, annual production records were achieved at the Williams Lake and Chetwynd mills. Total lumber production in 1998

was 1,513 MMfbm compared to 1,544 MMfbm in 1997 and shipments were 1,540 MMfbm compared to 1,569 MMfbm in 1997.

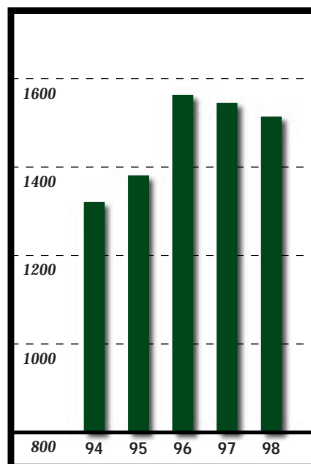
The operations at Terrace and Prince Rupert continued to suffer from difficult operating conditions and took downtime during the year and operated at reduced rates in the last quarter. Weak demand and prices in the key Japanese and U.S. northeast hemlock markets were significant factors. High log costs resulting from difficult terrain and over-regulation contributed to the poor results. Finding long-term solutions at these operations remains a key management focus.

Lumber demand in the United States strengthened as a result of increased housing activity fueled by low interest rates and low unemployment. However, softer market conditions in Japan, combined with increased lumber output in the United States

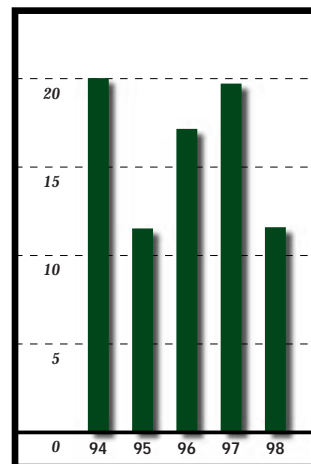
**OPERATING EARNINGS LUMBER (\$ millions)**



**LUMBER PRODUCTION (MMfbm)**



**LUMBER SAFETY (injuries per million hours worked)**



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and eastern Canada, kept downward pressure on prices. The 1998 average price of U.S. \$288 per Mfbm for the bellwether 2 X 4 SPF in the U.S. market was down over 18% compared to 1997.

In addition, the U.S. lumber quota, which requires substantial penalty payments for shipments in excess of assigned volumes, affected both shipments and sales revenues. During 1998 West Fraser continued to sell to Canadian customers to offset the quota restrictions, but at a discounted price to reflect the quota penalty.

West Fraser consumes approximately the same volume of wood chips as produced by its sawmilling operations. Prices for wood chips, which are based primarily on the price of market pulp, were largely unchanged from 1997.

The high cost of timber in British Columbia continues to be a challenge. Industry has worked closely with the B.C. government to implement changes to the Forest Practices Code and related regulations. These changes, aimed at reducing red tape and increasing efficiency, along with an intense

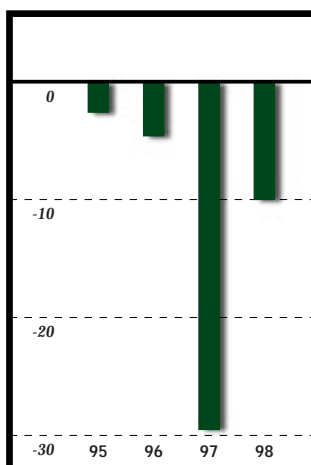
focus on controllable costs, enabled West Fraser to reduce its non-stumpage costs and total delivered log costs. This improvement was achieved in spite of high stumpage rates in the British Columbia interior during the first quarter of 1998. The June 1, 1998 stumpage price correction combined, with cost adjustments related to lower lumber prices, resulted in lower stumpage costs in the second half of the year.

In 1998 the Alberta operations experienced a number of lightning-caused forest fires within West Fraser's timber tenures. As a result, modifications were made to the Blue Ridge mill which will allow the processing of fire-killed timber for about two years.

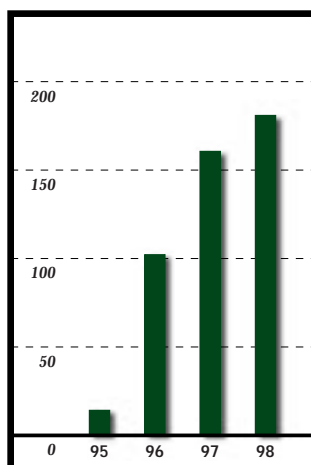
West Fraser is working together with the province of Alberta to initiate intensive silviculture practices which are expected to minimize the future effect on AAC.

In 1998 West Fraser spent \$43.3 million on various capital projects including a state-of-the-art planer mill at the Quesnel sawmill, and a major upgrade of the Blue Ridge sawmill.

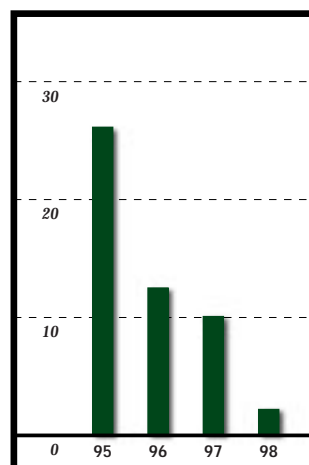
**OPERATING EARNINGS**  
MDF (\$ millions)



**MDF PRODUCTION**  
(MMSF)



**MDF SAFETY**  
(injuries per million hours worked)



# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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### MDF

The operating loss from MDF was \$10.0 million (1997 - \$29.6 million) on sales of \$78.3 million (1997 - \$71.6 million). Cash used in operating activities was \$3.2 million (1997 - \$22.8 million). The reduction in operating loss was due to increased production, improved sales mix and a continued focus on cost control.

The combined production of Ranger Board and WestPine MDF was 181 MMsf in 1998 compared to 161 MMsf in 1997. The 1998 shipments were 180 MMsf compared to 158 MMsf in 1997. Production at WestPine increased from the previous year, but remained below its capacity. During 1998 Ranger Board exceeded design capacity, in spite of interruptions caused by the forest fires, and achieved major cost reductions, yielding a modest profit at what is believed to be the bottom of the market.

West Fraser changed its MDF marketing strategy in 1998 from utilization of distributors to direct sales. In addition to reducing distribution and selling expenses, the new sales approach allows for more direct customer input into product development and improved customer service and market understanding. Thin board (3-8 mm) and other value-added products were successfully introduced to WestPine's product line during 1998, resulting in improved sales realizations.

West Fraser's MDF business continues to focus on increasing production and reducing costs.

### PULP AND PAPER

The operating earnings from pulp and paper were \$38.8 million (1997 - \$25.3 million) on external sales of \$441.5 million (1997 - \$441.0 million). Cash provided by operating activities was

\$31.2 million (1997 - \$47.5 million). In 1998 markets for most of West Fraser's pulp and paper products continued to be plagued by oversupply and low prices. Newsprint was the exception, as strikes among large producers allowed the rest of the industry to operate at full capacity with attractive prices.

#### Linerboard and Kraft Paper

The combined linerboard and kraft paper production at the Kitimat mill was 415,460 tonnes in 1998 compared to 411,098 tonnes in 1997. In 1998 shipments were 387,378 tonnes compared to 412,634 tonnes in 1997.

In the second half of 1998, as recent capital investments became effective, the mill achieved several production records. A shoe press installed on the linerboard machine in May has been a significant factor in reaching the higher production levels. In the course of the start-up of the mill following the May shutdown, a serious recovery-boiler leak was discovered. The leak required emergency repairs entailing approximately seven days of unplanned shutdown. Testing and monitoring procedures have been established to ensure that similar problems will not occur in the future.

Linerboard prices fell in the second half of the year due to high industry operating rates relative to the greatly reduced overall demand brought about by the Asian financial crisis. The Eurocan mill reduced sales to Korea and other Asian markets by approximately 80,000 tonnes. This reduction was largely offset by increased sales to Europe and to new markets in both North and South America.

The market for high strength, multiwall kraft paper is less than one million tonnes worldwide. The Middle East is a key market for this grade of

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paper for use in cement sacks. The significant drop in oil prices has caused a slow-down or postponement of many construction projects resulting in a reduced demand for multiwall kraft paper and an increase in competition in other markets.

In spite of difficult market conditions, mill net realizations were higher in 1998 than in 1997 due mainly to the weaker Canadian dollar. Mill nets for linerboard and kraft paper were approximately \$35/tonne and \$20/tonne higher respectively than in 1997. However, in spite of improved demand for linerboard, the fourth quarter price was approximately \$50/tonne below the 1998 average price.

A new collective agreement for the hourly work force was successfully concluded in November. The agreement, which expires in 2003, recognizes the need to improve operating efficiencies by increasing operating time and allowing better utilization of manpower through greater labour flexibility, particularly in the area of maintenance. The Kitimat mill also reduced its salaried manning

through a voluntary early retirement arrangement accepted by 28 employees. The cost of this program was charged to 1998 earnings.

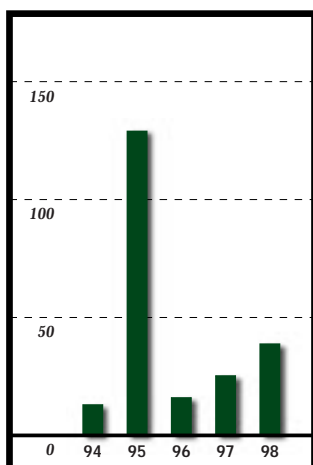
### Pulp

Pulp production at QRP and Slave Lake declined in the year to 288,020 tonnes compared to a total of 299,572 tonnes in 1997. The decrease was mainly the result of production interruptions at Slave Lake caused by forest fires in May and the rebuild of the pulp presses later in the year. In addition, the Slave Lake mill curtailed production by approximately 4,200 tonnes in response to the poor markets for hardwood BCTMP.

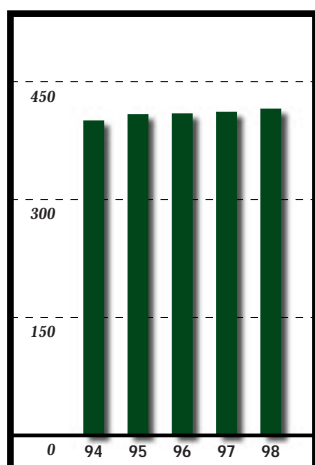
The benchmark NBSK price averaged U.S. \$544 compared to U.S. \$590 in 1997. BCTMP, which is priced relative to the NBSK price, recorded a similar decline.

The continuing economic difficulties in Asia had a negative impact on demand for all grades of pulp including both softwood and hardwood BCTMP produced by West Fraser. In total, West

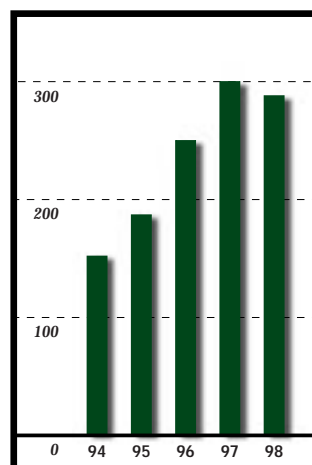
**OPERATING EARNINGS - PULP AND PAPER** (\$ millions)



**LINERBOARD AND KRAFT PAPER PRODUCTION** (thousands of tonnes)



**PULP PRODUCTION** (thousands of tonnes)



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*Operations Review*

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Fraser shipped 280,603 tonnes in the year compared to 295,335 tonnes in 1997.

The emphasis at West Fraser's pulp operations continues to be on cost control and operating at full production rates. The recent increases in production capacity to 165,000 tonnes are expected to lead to an improved cost structure at the Slave Lake mill.

**Newsprint**

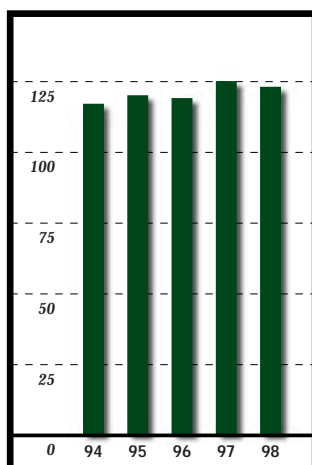
West Fraser's 50% share of production at the ANC mill in 1998 was 122,957 tonnes compared to 124,614 tonnes in 1997. West Fraser's share of newsprint shipments was 122,631 tonnes in 1998, compared to 124,495 tonnes in 1997.

Approximately 90% of the production was standard newsprint, with basis weights ranging from 45gm/m<sup>2</sup> to 52gm/m<sup>2</sup>. The remainder was Alberta Gold, a specialty rotogravure paper used in magazines and newspaper supplements.

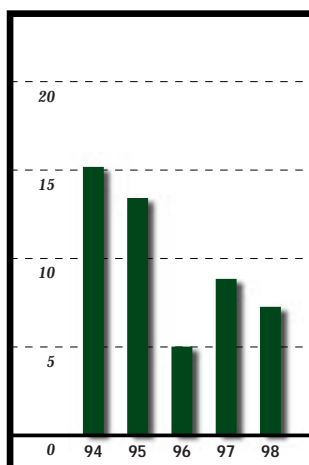
Average North American newsprint prices in 1998 were 4.5% higher than in 1997. Demand for newsprint improved due mainly to an increase in print advertising, which resulted in significantly increased newsprint consumption by daily newspapers. Labour disruptions at certain major newsprint suppliers also resulted in low publisher inventories at year-end. Prices remained essentially flat for most of the year, with a temporary increase in the fourth quarter.

The Alberta forest fires caused a brief shutdown of the mill in 1998. As a result of the fires, the mill is sourcing wood chips from some non-traditional sources in order to meet its newsprint quality requirements.

**NEWSPRINT PRODUCTION**  
(thousands of tonnes)



**PULP AND PAPER SAFETY**  
(injuries per million hours worked)



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### RETAIL HOME IMPROVEMENT

The operating earnings from retail home improvement were \$29.0 million (1997 – \$26.8 million) on sales of \$688.2 million (1997 – \$546.9 million). Cash provided by operating activities was \$19.6 million (1997 – \$27.8 million). The increase in sales and operating earnings largely reflects the acquisition of Lansing Buildall, included in results since May 22, 1998, and the addition of new Revy Home & Garden stores in Winnipeg, Manitoba and Abbotsford, British Columbia. Margins remained consistent with the previous year despite greater competitive pressure in certain markets. Operating expenses were higher as a result of the acquisition and computer system enhancements. Pre-opening expenses were higher, as three stores were opened in 1998 compared to two in 1997.

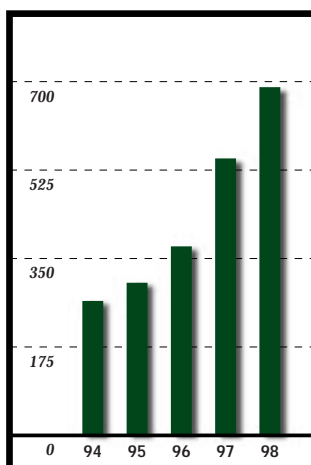
With the addition of Lansing Buildall, West Fraser acquired an established retail home improvement chain operating nine stores in metropolitan Toronto. Lansing's market share and

infrastructure will allow the expansion of the Revy full-service warehouse concept in Ontario. In May, a full-service warehouse store was opened in greater Toronto under the Lansing banner.

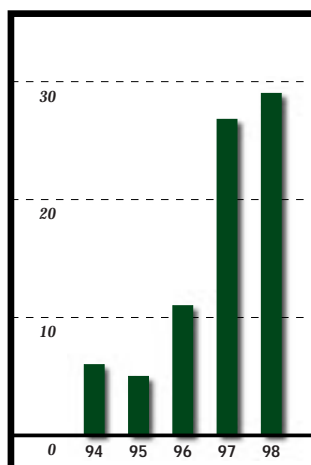
During the year, two of the Lumberland stores acquired in 1997 were closed. The remaining stores were renovated and are performing satisfactorily despite the present poor economic climate in British Columbia.

At the end of 1998 the Company's retail space was 2.6 million square feet compared to 2.2 million square feet at the end of 1997. Revy intends to open its third warehouse store in Calgary in the first quarter of 1999. Revy also intends to open two stores in Toronto in the second half of 1999.

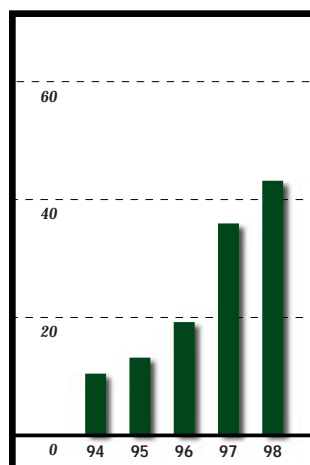
SALES – RETAIL HOME IMPROVEMENT (\$ millions)



OPERATING EARNINGS – RETAIL HOME IMPROVEMENT (\$ millions)



EBITDA – RETAIL HOME IMPROVEMENT (\$ millions)



Earnings before interest, taxes and depreciation and amortization.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Financial Review

### EARNINGS AND REVENUE COMPARISON

Consolidated net sales for the year were \$1,863.4 million (1997 – \$1,869.8 million). Lumber sales decreased by 18% while retail sales and MDF sales increased by 26% and 9% respectively. Sales in pulp and paper remained relatively unchanged. The decrease in lumber sales was primarily due to lower lumber prices experienced in 1998 in combination with a 28.6 MMfbm reduction in volume shipped. The retail sales increase was primarily due to the inclusion of the Lansing Buildall stores from May 22, 1998 combined with new store openings. The MDF sales increase was largely the result of increased shipments. In 1998, losses of \$14.5 million from foreign exchange contracts were deducted from net sales.

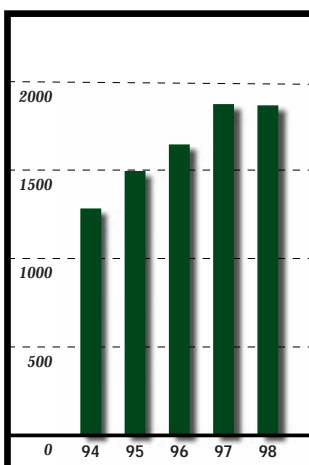
Net earnings decreased to \$5.6 million from \$69.5 million for 1997. The number of common shares outstanding at December 31, 1998 increased to 29,070,392 compared to 28,976,532 at the end of 1997. Fully diluted earnings per share were

\$0.05 in 1998 compared to \$2.30 in 1997. Per share earnings are based on earnings after deducting preferred share dividends and the charge for the convertible obligation and assume the exercise of dilutive options at the beginning of the year or on their dates of issue, if later.

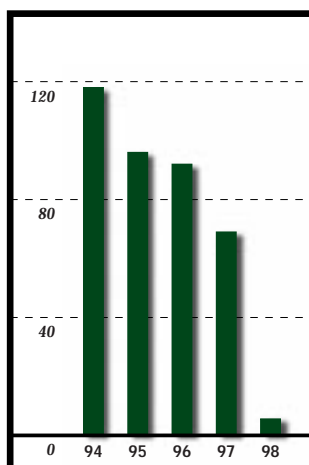
Operating earnings decreased by \$62.8 million or 35% from 1997. On a segmented basis, the decline in operating earnings included: a decline of \$91.3 million in lumber operations due primarily to reduced prices; an increase of \$19.6 million in MDF operations due primarily to increased production volumes and reduced production costs; an increase of \$13.5 million in pulp and paper primarily due to moderate year-over-year price increases in newsprint and linerboard; and an increase of \$2.2 million in the retail operations.

Other expense of \$11.4 million for the year compared to other income of \$2.9 million for 1997. The difference related mainly to \$6.7 million of early retirement and severance payments and \$2.7 million related to a reduction

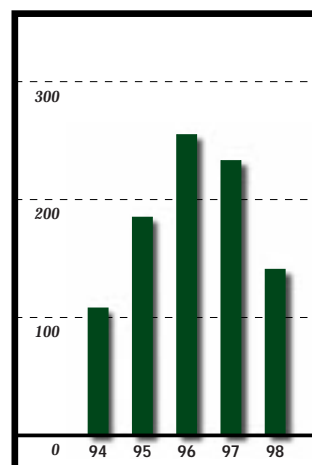
**NET SALES**  
(\$ millions)



**NET EARNINGS**  
(\$ millions)



**CASH FLOW FROM OPERATING ACTIVITIES**  
(\$ millions)



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in earnings from equity investments.

The amortization of deferred foreign exchange loss increased by \$10.2 million from 1997 due to the further decline of the Canadian dollar and to the prepayment of the non-recourse debt denominated in U.S. dollars.

Total taxes and tax-like levies and charges are as shown below:

<b>PAYMENTS TO GOVERNMENT</b>		
(\$ MILLIONS)		
	1998	1997
Income Tax	18.1	43.7
Corporation Capital Tax	3.6	3.2
Provincial Capital Tax	3.3	3.3
Canada Pension Plan	5.6	4.8
Employment Insurance	7.5	7.5
Property Tax	19.5	17.3
Social Service Tax	12.4	17.0
Stumpage and Royalties	115.0	124.0
Workers Compensation	8.8	9.0
<b>Total</b>	<b>193.8</b>	<b>229.8</b>

The majority of payments to government disclosed in the table above do not have either a direct or indirect relationship to profitability.

The 1998 provision for income taxes of \$21.7 million was 79.4% of earnings before income taxes. The extremely high tax rate was due to capital taxes which do not vary with earnings, and amortization related to acquisitions and amortization of deferred foreign exchange which are not deductible for tax purposes.

### CAPITAL STRUCTURE

The capital of West Fraser is comprised of debt and shareholders' equity. Included in shareholders'

equity is a convertible obligation which arose as a result of the Lansing Buildall acquisition. Reference is made to note 10 of the audited financial statements included in this Annual Report for a description of the obligation.

During 1998 the Company issued 93,860 common shares under its various share purchase and option plans.

On March 18, 1998, the Company repaid its non-recourse debt associated with ANC using the proceeds from long-term debt issued in November 1997. All of West Fraser's debt, other than its current borrowings for ANC, are now unsecured and rank equally in right of payment.

On December 31, 1998 the ratio of West Fraser's total debt, less cash, to total capitalization was .47 compared to .46 at the end of 1997. The increase in the ratio is a result of the higher carrying value of the U.S. dollar denominated debt.

West Fraser's fixed-interest term debt is rated by leading rating agencies as follows:

<b>AGENCY</b>	<b>RATING</b>
Canadian Bond Rating Service	A (low)
Dominion Bond Rating Service	BBB
Moody's	BAA 3
Standard & Poors	BBB-

### CAPITAL REQUIREMENTS AND LIQUIDITY

West Fraser's annual cash requirements, other than for operating purposes, include interest on, and repayment of, debt, payment of dividends and capital asset additions. In years without a significant acquisition, cash provided by operations has generally been sufficient to meet these requirements.

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*Risks and Uncertainties*

In 1998 capital asset additions together with acquisitions amounted to \$157.7 million compared to \$156.2 million in 1997. Proceeds from capital asset disposals were \$34.1 million in 1998 compared to \$6.9 million in 1997. Of the 1998 disposals \$29.0 million related to retail properties subsequently leased back under long-term leases.

West Fraser plans to spend approximately \$100 million on capital asset additions in 1999, mostly on business improvements, capital replacements, construction of retail stores and acquisition of store sites.

West Fraser's scheduled repayment of long-term debt in 1999 is \$42.2 million.

In 1999 West Fraser intends to meet all of its cash requirements for planned capital additions, debt repayments, interest and dividends with funds generated from operations. At December 31, 1998 it had unused credit facilities of approximately \$360 million.

price. This results in significant sensitivity to changes in the U.S.-Canadian dollar exchange rate.

In addition, payment for export sales may occur in the currency of the purchaser resulting in an additional exchange rate sensitivity to a broad range of major foreign currencies. Exchange rate fluctuations between the times of purchase and payment, which may be up to 120 days, result in gains or losses on final settlement. There are no material future obligations under forward-exchange contracts outstanding at year end.

During the year the U.S. dollar traded between Cdn. \$1.59 and Cdn. \$1.40. The range in 1997 was between Cdn. \$1.44 and Cdn. \$1.34. The average exchange value for 1998 was \$1.48 compared to \$1.38 for 1997.

**Environment**

The "Environmental Report" which appears on page 56 is incorporated herein by reference.

**CAPITAL ASSET ADDITIONS AND  
ACQUISITIONS (\$ MILLIONS)**

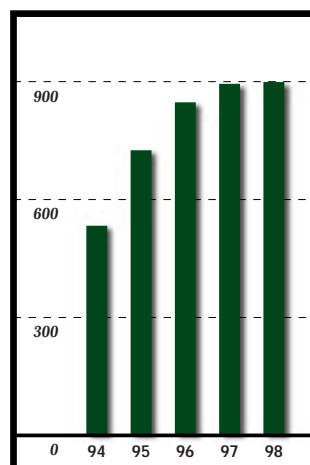
	1998	1997
Lumber	<b>\$43.3</b>	\$59.3
MDF	2.2	5.7
Pulp and paper	27.7	37.3
Retail home improvement	<b>79.0</b>	43.2
Corporate and other	5.5	10.7
<b>Total</b>	<b>\$157.7</b>	<b>\$156.2</b>

**RISKS AND UNCERTAINTIES**

**Foreign Exchange**

More than 60% of West Fraser's net sales are produced from the sale of forest products to customers at prices which, although denominated in a variety of currencies, are based on the prevailing U.S. dollar

**SHAREHOLDERS' EQUITY  
(\$ millions)**



# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Risks and Uncertainties

### Land Claims

Aboriginal land claims have created considerable uncertainty for the forest industry in British Columbia. In 1997 the *Delgamuukw* decision by the Supreme Court of Canada made reference to aboriginal title and rights in respect of Crown land and resources as well as the Crown's ability to override such rights. However, it is likely that aboriginal title and rights will continue to be negotiated or litigated, as this decision did not provide a clear definition.

In 1998 the governments of British Columbia and Canada completed treaty negotiations with the Nisga'a. The treaty has been approved by the Nisga'a but has not yet been approved by the provincial legislature or federal parliament and is the subject of several court challenges. If approved in its current form the treaty is not expected to have a material impact on West Fraser. Neither the issue of compensation for companies adversely affected by the Nisga'a treaty due to loss of timber supply, nor the issue of continued access to timber supply, have yet been fully addressed by the federal or provincial government.

### Year 2000 Date Issue

The Year 2000 issue (Y2K) arises because many computerized systems use two rather than four digits to identify a year and date sensitive systems may recognize the year 2000 as 1900. If not addressed, these systems may fail or otherwise affect an entity's ability to conduct normal business operations.

In 1996, West Fraser initiated a process to address issues related to Y2K. A detailed inventory of all computerized business systems was completed, followed by an evaluation of each system. Priority was assessed as critical or non-critical according to the potential impact on operations should failure

occur. A plan of remediation and post-remediation testing was developed.

By the end of 1998 the majority of West Fraser's critical systems were remedied, tested and confirmed as Y2K compliant. Those critical systems that are not yet compliant will be remedied, tested and confirmed as Y2K compliant during 1999. In addition, the suppliers of these systems were asked to provide information and assurance with respect to the compliance of their equipment.

West Fraser began contacting suppliers of strategic products and services, including transportation and energy, to obtain a reasonable level of assurance that the supply of these products and services will continue uninterrupted beyond 1999. It is expected that this process will continue throughout 1999. Major customers are also being approached in order to ascertain their Y2K readiness. West Fraser has also been contacted by many of its customers as to its Y2K readiness. West Fraser's board of directors receives regular reports on the status of Y2K.

West Fraser's program of addressing the Y2K issue has proceeded within the context of its continuing upgrading of its information technology systems. Many Y2K issues have been dealt with in the process of this general and normal course upgrading and, as a result, actual direct costs specifically attributable to the Y2K issue are not readily identifiable. Management's view is that in the context of West Fraser's information technology expenditures the costs attributable to Y2K have not been material. In addition, remaining costs to complete the Y2K process are not expected to be material.

While it is impossible to obtain certainty that

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*Risks and Uncertainties*

West Fraser will be unaffected by failures resulting from the Y2K issue, management believes that the process undertaken will result in minimal disruptions through the transition to the year 2000.

**EARNINGS SENSITIVITY**

West Fraser's earnings are sensitive to changes in world economic conditions, primarily those in North America, Europe and the Far East. Most of its revenues are from sales of commodities for which prices are sensitive to variations in supply and demand. Since most of these sales are in foreign currencies, mainly U.S. dollars, currency exchange fluctuations are a sensitivity factor.

West Fraser's principal raw material is timber. Stumpage charges on logs harvested from its timber tenures are partially indexed to the market price of lumber, both in British Columbia and in Alberta, although each province follows a different market index and a different policy to make changes to stumpage. The prices paid for logs obtained in the open market are the result of competitive bidding

between mills seeking incremental volumes.

West Fraser is a significant consumer of electrical power and therefore changes in the prices and terms of the supply contracts with various utilities and a third party affects its earnings. Beginning in 1998 electricity in Alberta is sold at prices which reflect current supply and demand. As a result, the price for electricity may vary significantly even to a point which may require short-term production curtailments. Operations which are most affected are Slave Lake, ANC and the Ranger Board mills.

Interest rates, particularly in the United States, have a significant effect on house construction activity, which in turn influences the demand for, and price of, lumber. Sales of existing homes and construction of new homes, together with general economic conditions in the area of retail stores, are factors affecting profitability of the retail home improvement business.

The following table shows the annual after-tax effect on earnings of certain key variables, based on expected 1999 production, sales and usage:

<b>SENSITIVITY TO KEY VARIABLES</b>		
<b>FACTOR</b>	<b>VARIATION</b>	<b>CHANGE IN EARNINGS</b>
Lumber price	U.S. \$50 change per Mfbm	\$48.0 million
MDF price	U.S. \$50 change per Msf	\$9.0 million
BCTMP price	U.S. \$50 change per tonne	\$10.5 million
Linerboard price	U.S. \$50 change per tonne	\$15.0 million
Kraft paper price	U.S. \$50 change per tonne	\$5.5 million
Newsprint price	U.S. \$50 change per tonne	\$5.5 million
U.S. - Cdn \$ exchange rate	U.S. \$0.01 change per Cdn \$	\$10.0 million
Log cost	\$10 change per m <sup>3</sup>	\$34.5 million
Electricity price	10% change	\$4.5 million

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### *Business Outlook*

The financial performance of West Fraser is dependent on commodity prices, the external value of the Canadian dollar, government policies affecting timber harvesting, and the cost structure of each of its businesses. West Fraser's retail home improvement business is influenced by the level of general economic activity in Canada, particularly home construction in the areas where its stores are located.

In the past the forest industry has generated low returns on capital employed. Some of the recent mergers, which have resulted in capacity reductions, together with fewer new-capacity additions, are expected to result in improved industry profitability.

The turmoil caused by Asian financial markets is not expected to cause a worldwide recession in 1999. In the foreseeable future most economies should continue to grow, albeit at reduced levels. Interest rates should remain low both in the United States and Canada, thereby continuing to benefit the housing sector. The demand for lumber in the United States should remain high by historic standards, although at a lower level than in 1998. The anticipated modest improvement in the Asian demand for lumber will, to some degree, reduce the current lumber oversupply.

In 1998 costs of timber harvesting in British Columbia remained higher than anywhere else in Canada. Further steps should be taken in 1999 to bring this province's cost structure more in line with the other supplying regions. The Canada-U.S. Softwood Lumber Agreement continues to limit the volume of lumber which can be exported to the United States without penalty fees.

Notwithstanding the high timber harvesting costs and the additional costs imposed by the lumber quota, West Fraser's interior sawmills should

remain profitable due to their well-established low cost structure and operating style. However, finding a solution for West Fraser's coastal operations at Terrace and Prince Rupert remains a high priority.

MDF-capacity increases seem to have been absorbed in North America. However, the reduced Asian demand has increased imports to the North American markets, making it more difficult to achieve meaningful price increases in West Fraser's main MDF market areas.

One of the key objectives in 1999 is to improve operating efficiencies of the WestPine MDF plant. While the progress achieved in 1998 was significant, continued efforts in all aspects of this operation will be required in 1999 and beyond to achieve acceptable levels of operating efficiency and profitability.

The combination of closing high-cost, inefficient pulp and paper mills and reductions in capital spending for new capacity should result in lower inventory levels and gradually improving product prices. Linerboard should be one of the first products to benefit from these trends. However, for market pulp and most paper grades, the anticipated slower growth of the world GDP in 1999 is likely to offset the benefit of capacity closures.

In 1999 a key target for West Fraser's pulp business is to achieve a cost structure for the Slave Lake mill that allows it to operate profitably even at the bottom of the pulp cycle.

At the Eurocan Pulp & Paper mill, the continued efforts to reduce costs and increase operating efficiencies are paying off. Another important factor in achieving better financial results at this operation is its ability to sell out its kraft paper capacity rather than produce lightweight linerboard. While the

**MANAGEMENT'S DISCUSSION AND  
ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS**

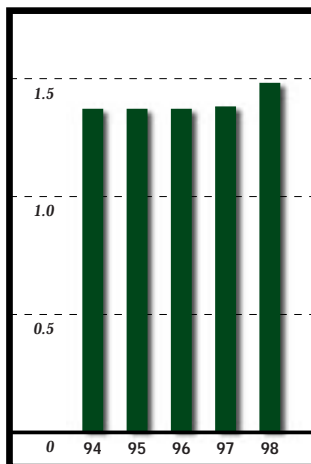
*Business Outlook*

short-term outlook for kraft paper is less robust than for linerboard, overall, the Eurocan operations should show improved earnings over 1998.

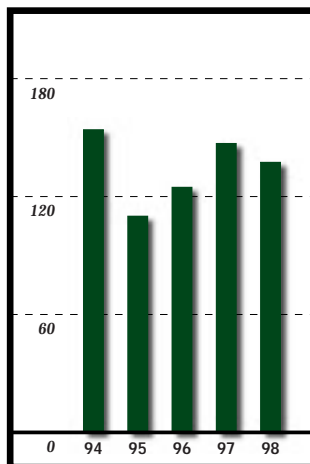
The significant consolidation that has already happened in the newsprint industry should moderate the otherwise bearish outlook for this paper grade. As a low-cost, high-efficiency producer, ANC should continue to earn a return above the industry norm.

In recent years a significant part of West Fraser's growth has come from the retail home improvement business. In 1998, the objective of achieving a national presence was attained with the acquisition of the Lansing chain in Ontario. The introduction of Revy Home & Garden stores in that market in 1999 is expected to greatly solidify Revy's position as a national chain.

**AVERAGE US/CDN  
TRADING VALUE (\$)**



**CANADIAN HOUSING  
STARTS (thousands)**



**U.S. HOUSING STARTS  
(millions)**

