

# **West Fraser Timber Co. Ltd.**

Consolidated Financial Statements  
**December 31, 2006 and 2005**  
(in thousands of Canadian dollars)

## **Auditors' Report**

### **To the Shareholders of West Fraser Timber Co. Ltd.**

We have audited the consolidated balance sheets of **West Fraser Timber Co. Ltd.** as at December 31, 2006 and 2005 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

### **Chartered Accountants**

Vancouver, British Columbia  
February 15, 2007

# West Fraser Timber Co. Ltd.

## Consolidated Balance Sheets

As at December 31, 2006 and 2005

(in thousands of Canadian dollars)

	2006	2005
<b>Assets</b>		
<b>Current assets</b>		
Cash and short-term investments	\$ 605,574	\$ 62,199
Accounts receivable	300,919	308,509
Inventories (note 4)	531,873	572,004
Prepaid expenses	12,921	14,081
Current assets held for sale (note 5)	-	30,739
	<u>1,451,287</u>	<u>987,532</u>
<b>Property, plant, equipment and timber</b> (note 6)	2,133,914	2,230,055
<b>Deferred charges</b> (note 7)	41,826	27,143
<b>Goodwill</b>	263,719	263,719
<b>Other assets</b> (note 8)	127,689	61,537
<b>Long-term assets held for sale</b> (note 5)	-	63,697
	<u>\$ 4,018,435</u>	<u>\$ 3,633,683</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities</b>		
Cheques issued in excess of funds on deposit	\$ -	\$ 43,899
Operating loans (note 9)	-	165,111
Accounts payable and accrued liabilities	468,429	333,075
Income taxes payable	178,861	4,661
Current portion of reforestation obligations (note 10)	54,222	52,319
Current portion of long-term debt (note 9)	128,284	4,500
Current liabilities held for sale (note 5)	-	13,555
	<u>829,796</u>	<u>617,120</u>
<b>Long-term debt</b> (note 9)	499,620	623,860
<b>Other liabilities</b> (note 10)	137,446	132,960
<b>Future income taxes</b> (note 20)	312,443	377,637
<b>Long-term liabilities held for sale</b> (note 5)	-	16,187
	<u>1,779,305</u>	<u>1,767,764</u>
<b>Shareholders' equity</b> (note 11)	2,239,130	1,865,919
	<u>\$ 4,018,435</u>	<u>\$ 3,633,683</u>
<b>Commitments</b> (note 12)		

Approved by the Board of Directors



William P. Ketcham  
Director



J. Duncan Gibson  
Director

# West Fraser Timber Co. Ltd.

## Consolidated Statements of Earnings

For the years ended December 31, 2006 and 2005

(in thousands of Canadian dollars, except earnings per share)

	2006	2005
<b>Sales</b>	\$ 3,325,835	\$ 3,576,701
<b>Costs and expenses</b>		
Cost of products sold	2,296,157	2,321,785
Freight and other distribution costs	543,663	541,966
Export taxes	16,755	-
Amortization	251,869	255,384
Selling, general and administration	113,896	120,318
Share option recovery (note 2)	(1,233)	(5,666)
Restructuring charge (note 15)	37,631	-
Duty (refund) expense (note 16)	(325,395)	151,431
	<u>2,933,343</u>	<u>3,385,218</u>
<b>Operating earnings</b>	392,492	191,483
<b>Other</b>		
Interest income on duty refund	50,032	-
Interest expense - net (note 17)	(37,592)	(48,424)
Exchange (loss) gain on long-term debt	(720)	13,850
Gain on sale of power purchase agreement (note 8)	61,793	-
Gain on assets held for sale (note 5)	21,686	-
Gain on timber take-back (note 18)	13,609	3,300
Other income (expense) (note 19)	20,984	(8,771)
	<u>522,284</u>	<u>151,438</u>
<b>Earnings before income taxes and non-controlling interest</b>	522,284	151,438
<b>(Provision for) recovery of income taxes</b> (note 20)		
Current	(181,741)	(66,878)
Future	57,885	24,581
	<u>(123,856)</u>	<u>(42,297)</u>
<b>Earnings before non-controlling interest</b>	398,428	109,141
<b>Non-controlling interest</b>	(431)	(1,491)
<b>Earnings</b>	<u>\$ 397,997</u>	<u>\$ 107,650</u>
<b>Earnings per share</b> (note 21)		
<b>Basic</b>	<u>\$ 9.31</u>	<u>\$ 2.52</u>
<b>Diluted</b>	<u>\$ 9.23</u>	<u>\$ 2.49</u>

**West Fraser Timber Co. Ltd.**  
Consolidated Statements of Retained Earnings  
For the years ended December 31, 2006 and 2005

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(in thousands of Canadian dollars)

	2006	2005
<b>Retained earnings</b>		
<b>Balance - beginning of year</b>	\$ 1,268,811	\$ 1,185,102
<b>Change in accounting policy</b> (note 2)	(1,548)	-
<b>Earnings</b>	397,997	107,650
	1,665,260	1,292,752
<b>Common share dividends</b>	(23,949)	(23,941)
<b>Balance - end of year</b>	\$ 1,641,311	\$ 1,268,811

# West Fraser Timber Co. Ltd.

## Consolidated Statements of Cash Flows

For the years ended December 31, 2006 and 2005

(in thousands of Canadian dollars)

	2006	2005
<b>Cash flows from operating activities</b>		
Earnings	\$ 397,997	\$ 107,650
Items not affecting cash		
Amortization	251,869	255,384
Writedown of pulp assets (note 15)	34,780	-
Exchange loss (gain) on long-term debt	720	(13,850)
Change in reforestation obligations	(6,266)	(2,134)
Change in other long-term liabilities	12,043	(67,043)
Change in deferred charges	(14,607)	9,101
Future income taxes	(59,043)	(24,326)
Gain on asset sales	(98,262)	(3,171)
Other	2,753	4,145
	<u>521,984</u>	<u>265,756</u>
Net change in non-cash working capital items	<u>358,214</u>	<u>(236,053)</u>
	<u>880,198</u>	<u>29,703</u>
<b>Cash flows from financing activities</b>		
Repayment of long-term debt	(1,200)	(249,300)
(Repayment of) net proceeds from operating loans	(165,111)	99,111
Common share dividends	(23,949)	(23,941)
Issuance of Common shares (note 11)	554	527
Other	156	166
	<u>(189,550)</u>	<u>(173,437)</u>
<b>Cash flows from investing activities</b>		
Additions to property, plant, equipment and timber	(211,630)	(224,401)
Proceeds from disposal of property, plant, equipment and timber	37,013	22,624
Net proceeds from assets held for sale (note 5)	81,429	-
Addition to power purchase agreement (note 8)	(17,527)	-
Decrease in other assets	7,341	14,248
	<u>(103,374)</u>	<u>(187,529)</u>
<b>Increase (decrease) in cash</b>	587,274	(331,263)
<b>Net cash - beginning of year</b>	18,300	349,563
<b>Net cash - end of year</b>	<u>\$ 605,574</u>	<u>\$ 18,300</u>
<b>Net cash consists of</b>		
Cash and short-term investments	\$ 605,574	\$ 62,199
Cheques issued in excess of funds on deposit	-	(43,899)
	<u>\$ 605,574</u>	<u>\$ 18,300</u>
<b>Supplemental information</b>		
<i>Interest paid</i>	<u>\$ 40,760</u>	<u>\$ 50,219</u>
<i>Income taxes paid</i>	<u>\$ 73,335</u>	<u>\$ 243,662</u>

# **West Fraser Timber Co. Ltd.**

## Notes to Consolidated Financial Statements

### **December 31, 2006 and 2005**

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(figures are in thousands of Canadian dollars, except where indicated)

## **1 Nature of operations and significant accounting policies**

### **Nature of operations**

The Company is an integrated forest products company producing lumber, panels and pulp and paper products.

### **Basis of presentation**

The Company's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles. Certain comparative figures have been reclassified to conform to the current year's presentation.

### **Principles of consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiaries. Principal direct and indirect operating subsidiaries are West Fraser Mills Ltd., West Fraser Forest Products Inc., Blue Ridge Lumber Inc., Ranger Board Inc., Alberta Plywood Ltd., West Fraser, Inc., (formerly West Fraser (South), Inc.), West Fraser Newsprint Ltd., and Sundre Forest Products Ltd.

Investments in and operations of the Company's joint ventures are accounted for by the proportionate consolidation method, except for consolidated variable interest entities.

### **Revenue recognition**

Revenues are derived from product sales and are recognized upon the transfer of significant risks and rewards of ownership, provided collectibility is reasonably assured.

### **Use of estimates**

The preparation of financial statements requires estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant areas requiring estimates are asset valuations, reforestation obligations, other asset retirement obligations and employee future benefits. Actual amounts could differ materially from those estimates.

### **Foreign currency translation**

Monetary assets and liabilities denominated in foreign currencies, including long-term debt, are translated into Canadian dollars at the exchange rates prevailing at the end of the period. Other assets and liabilities and income and expense items are translated at the exchange rates prevailing on the transaction dates. Resulting exchange gains or losses are included in earnings.

# West Fraser Timber Co. Ltd.

## Notes to Consolidated Financial Statements

### December 31, 2006 and 2005

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(figures are in thousands of Canadian dollars, except where indicated)

The Company's foreign operations are considered to be integrated. Accordingly, monetary items are translated at the rates of exchange in effect at the balance sheet dates, and non-monetary items are translated at historical exchange rates. Revenues and expenses are translated at the average rate of exchange in effect during the period in which they occur, except for amortization of assets, which is translated at the same historical exchange rate as the asset to which it relates. Gains or losses on the translation of monetary items are included in earnings.

#### **Cash and short-term investments**

Cash and short-term investments consist of cash on deposit and short-term interest-bearing securities with maturities at their purchase date of three months or less.

#### **Inventories**

Inventories of logs and manufactured products are valued at the lower of average cost and net realizable value. Inventories of other raw materials, processing materials and supplies are valued at the lower of average cost and replacement cost.

#### **Property, plant, equipment and timber**

Property, plant, equipment and timber are stated at cost less accumulated amortization. Major manufacturing assets under construction include capitalized interest and preproduction and start-up costs, where applicable. Expenditures for additions and improvements are capitalized. Expenditures for maintenance and repairs are charged to earnings. Upon retirement, disposal or destruction of assets, the cost and related amortization are removed from the accounts and any gain or loss is reflected in earnings.

Property, plant and equipment are principally amortized on a straight-line basis over their estimated useful lives as follows:

Buildings	10 - 30 years
Manufacturing equipment and machinery	10 - 20 years
Fixtures and other equipment	3 - 10 years

Timber rights and roads are amortized over a period not exceeding 60 years.

Capitalized preproduction and start-up costs are amortized over a period not exceeding five years.

#### **Goodwill**

Goodwill represents the excess of the purchase price paid for an acquisition over the fair value of the net assets acquired. Goodwill is not amortized, but is subject to an impairment test on at least an annual basis, or more frequently if events or circumstances indicate that it may be impaired.

# West Fraser Timber Co. Ltd.

## Notes to Consolidated Financial Statements

### December 31, 2006 and 2005

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(figures are in thousands of Canadian dollars, except where indicated)

Goodwill impairment is assessed based on a comparison of the fair value of a reporting unit to the underlying carrying value of the reporting unit's net assets, including goodwill. When the carrying amount of the reporting unit exceeds its fair value, the fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of impairment loss, if any.

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

The Company reviews property, plant, equipment and timber for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is assessed by comparing the carrying amount to the projected future net cash flows the long-lived assets are expected to generate.

#### **Asset retirement obligations**

The Company harvests timber under various timber rights. Estimated future reforestation obligations are accrued and charged to earnings at the time the timber is harvested. The reforestation obligation is reviewed periodically and changes to estimates are credited or charged to earnings.

The Company records the estimated fair value of a liability for other asset retirement obligations in the period a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset and amortized over its useful life. The liability is accreted over time through periodic charges to earnings and is reduced by actual costs of settlement.

#### **Share-based compensation**

The Company's share option plan gives share option holders the right to elect to receive a cash payment in lieu of exercising the option to purchase Common shares. The Company records an expense or recovery for share options, based on the quoted market value of the Company's Common shares. If an option holder elects to purchase Common shares, as opposed to receiving a cash payment, both the exercise price and the accrued liability is credited to shareholders' equity.

The Company's directors' deferred share unit plan ("DDSU") allows for settlements in cash or Common shares at the holder's option and, therefore, is accounted for as a liability. Changes in the Company's obligations under the DDSU, which arise from fluctuations in the market price of the Company's Common shares underlying this plan, are recorded in selling, general and administration expenses.

# West Fraser Timber Co. Ltd.

## Notes to Consolidated Financial Statements

### December 31, 2006 and 2005

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(figures are in thousands of Canadian dollars, except where indicated)

#### **Employee future benefits**

The Company accrues for its obligations under employee benefit plans and the related costs net of plan assets.

The Company has adopted the following policies:

- The measurement date used for accounting purposes is October 31;
- The cost of pensions earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's estimate of expected plan investment performance, salary escalation and retirement ages of employees;
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value;
- Past service costs arising from plan amendments and transitional obligations are amortized on a straight-line basis over the estimated average remaining service period of employees active at the date of the amendments;
- The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of the active employees.

For defined contribution plans, the pension expense is the amount of contributions the Company is required to pay for services rendered by employees.

#### **Income taxes**

Future income taxes are provided for using the liability method. Under the liability method, future income taxes are recognized for temporary differences between the tax and financial statement bases of assets, liabilities and certain carry-forward items.

Future income tax assets are recognized only to the extent that it is more likely than not that they will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

**West Fraser Timber Co. Ltd.**  
Notes to Consolidated Financial Statements  
**December 31, 2006 and 2005**

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(figures are in thousands of Canadian dollars, except where indicated)

**2 Change in accounting policy**

Effective December 31, 2006 the Company adopted the new provision of the Emerging Issue Committee pronouncement No. 162 for share-based compensation for directors, officers and employees eligible to retire before the vesting date. Compensation expense is now recognized over the earlier of the normal vesting period or the period from the grant date to the date the employee becomes eligible to retire. Pursuant to the transition provision, the Company recorded an adjustment of \$1,548 (net of tax of \$791) to opening 2006 retained earnings for the cumulative effect on prior years arising from this change in accounting policy. The Company has not restated earnings of any prior period as a result of adopting this accounting change as the Company has concluded that such an impact is not material. The fiscal 2006 income statement effect of adopting this change in policy was an increase in earnings of \$1,640 (net of tax of \$838).

**3 Investment in joint ventures**

The Company's joint ventures are Alberta Newsprint Company (50%) and Cariboo Pulp and Paper Company (50%). The Company's proportionate share of the joint ventures is as follows:

	<b>2006</b>		<b>2005</b>
Current assets	\$ 66,213	\$	57,078
Non-current assets	174,158		149,096
	<hr/>		<hr/>
Total assets	240,371		206,174
Current liabilities	(26,877)		(23,510)
Non-current liabilities	(22,887)		(22,396)
	<hr/>		<hr/>
Equity	\$ 190,607	\$	160,268
	<hr/>		<hr/>
Sales	\$ 215,595	\$	198,670
Costs and expenses	(161,061)		(186,472)
	<hr/>		<hr/>
Earnings before income taxes	\$ 54,534	\$	12,198
	<hr/>		<hr/>
Cash flows from operating activities	\$ 54,595	\$	40,607
	<hr/>		<hr/>
Cash flows from financing activities	\$ 127	\$	-
	<hr/>		<hr/>
Cash flows from investing activities	\$ (22,230)	\$	(10,403)
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The Company has business transactions with certain of its joint venture participants and entities related to these participants. All transactions are at market prices and on normal business terms.

**West Fraser Timber Co. Ltd.**  
Notes to Consolidated Financial Statements  
December 31, 2006 and 2005

(figures are in thousands of Canadian dollars, except where indicated)

**4 Inventories**

	<b>2006</b>		<b>2005</b>	
Logs and wood chips	\$	170,318	\$	178,103
Manufactured products		269,571		305,609
Processing materials and supplies		91,984		88,292
	\$	<u>531,873</u>	\$	<u>572,004</u>

**5 Assets held for sale**

The Company sold its interest in two sawmills and the related timber harvesting rights for net proceeds of \$79,228, resulting in a gain of \$21,547. The Company also sold road maintenance and logging operations located in Hinton, Alberta for proceeds of \$2,201, resulting in a gain of \$139.

The results of operations from these assets to the sale dates are included in earnings. Effective January 1, 2006, amortization was discontinued on the assets held for sale.

**6 Property, plant, equipment and timber**

	<b>2006</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
Manufacturing plant, equipment and machinery	\$ 3,207,455	\$ 1,781,682	\$ 1,425,773
Construction-in-progress	73,261	-	73,261
Timber rights and roads	806,703	208,499	598,204
Rental properties	15,584	4,055	11,529
Other	28,089	2,942	25,147
	<u>\$ 4,131,092</u>	<u>\$ 1,997,178</u>	<u>\$ 2,133,914</u>
	<b>2005</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
Manufacturing plant, equipment and machinery	\$ 3,136,882	\$ 1,690,656	\$ 1,446,226
Construction-in-progress	99,581	-	99,581
Timber rights and roads	854,330	208,988	645,342
Rental properties	19,632	5,299	14,333
Other	26,836	2,263	24,573
	<u>\$ 4,137,261</u>	<u>\$ 1,907,206</u>	<u>\$ 2,230,055</u>

**West Fraser Timber Co. Ltd.**  
Notes to Consolidated Financial Statements  
December 31, 2006 and 2005

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(figures are in thousands of Canadian dollars, except where indicated)

**7 Deferred charges**

	<b>2006</b>	<b>2005</b>
Deferred pension (note 13)	\$ 35,634	\$ 20,760
Deferred financing fees - net	5,164	6,383
Deferred transaction costs (note 12)	1,028	-
	<u>\$ 41,826</u>	<u>\$ 27,143</u>

Deferred financing fees are amortized over the term of the related debt.

**8 Other assets**

	<b>2006</b>	<b>2005</b>
Power purchase agreements - net	\$ 102,442	\$ 28,673
Investments	10,712	15,822
Advances for timber and timber deposits	14,535	17,042
	<u>\$ 127,689</u>	<u>\$ 61,537</u>

**Power purchase agreements**

Effective January 1, 2001, the Company entered into two power purchase agreements to acquire a portion of the electricity generated from two power plants in Alberta at substantially predetermined prices. The Company sells the electricity acquired under the power purchase agreement at prevailing market prices. At the same time, the Company's Alberta operations purchase electricity at prevailing market prices. Effective May 1, 2006, the Company sold its interest in one of the agreements for proceeds of \$68,211 while concurrently acquiring a greater interest in the remaining agreement for \$85,738. The transactions were accounted for as a sale and purchase respectively, resulting in a gain of \$61,793. Following the transactions, the Company's share of electricity generated was approximately 120 megawatts for 2006 and is expected to be 115 megawatts per year for the period 2007 to 2020. The power purchase agreement is amortized over the life of the agreement.

**West Fraser Timber Co. Ltd.**  
Notes to Consolidated Financial Statements  
December 31, 2006 and 2005

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(figures are in thousands of Canadian dollars, except where indicated)

**9 Long-term debt and operating loans**

**Long-term debt**

	<b>2006</b>	<b>2005</b>
Cdn \$125,000 debentures due 2007; interest at 6.80%	\$ 124,984	\$ 124,960
Cdn \$150,000 debentures due 2009; interest at 4.94%	150,000	150,000
US \$300,000 senior notes due 2014; interest at 5.20%	349,620	348,900
Cdn \$3,300 term note; interest at floating rates <sup>(1)</sup>	3,300	4,500
	<hr/>	<hr/>
	627,904	628,360
Less: Current portion	(128,284)	(4,500)
	<hr/>	<hr/>
	\$ 499,620	\$ 623,860
	<hr/>	<hr/>

<sup>(1)</sup> Floating rates are based on Prime, US base, Bankers Acceptances or LIBOR at the Company's option.

Interest payments are made on a semi-annual basis with the exception of the Cdn \$3,300 term note, which are made quarterly.

Principal repayments required are as follows:

2007	\$ 128,284
2008	-
2009	150,000
2010	-
2011	-
Thereafter	349,620
	<hr/>
	\$ 627,904
	<hr/>

**Operating loans**

The Company has approximately \$516,700 (2005 - \$530,000) in revolving lines of credit available, none of which was drawn as at December 31, 2006 (2005 - \$165,111). Interest is payable at floating rates based on Prime, US base, Bankers Acceptances or LIBOR at the Company's option. The Company has also issued \$14,863 (2005 - \$14,392) under various letters of credit.

All long-term debt and bank lines of credit are unsecured except for a \$5,000 joint venture line of credit which is secured by its working capital.

**West Fraser Timber Co. Ltd.**  
Notes to Consolidated Financial Statements  
December 31, 2006 and 2005

(figures are in thousands of Canadian dollars, except where indicated)

**10 Other liabilities**

	<b>2006</b>		<b>2005</b>
Post-retirement obligations (note 13)	\$ 54,029	\$	44,243
Timber damage deposits	14,605		10,921
Reforestation obligations - long-term	60,054		68,187
Other asset retirement obligations	8,758		9,609
	<u>\$ 137,446</u>	\$	<u>132,960</u>

**Asset retirement obligations**

The Company's asset retirement obligations relate to its responsibility for reforestation under various timber rights and to landfill closure and other site remediation costs.

Changes in asset retirement obligations are as follows:

	<u>Reforestation</u>		<u>Other</u>	
	<b>2006</b>	<b>2005</b>		
Asset retirement obligations - beginning of year	\$ 123,643	\$ 120,942	\$ 9,609	\$ 6,636
Liabilities recognized	40,234	44,182	-	-
Liabilities settled	(52,832)	(45,504)	(1,036)	(106)
Accretion expense	5,753	5,412	497	868
Change in estimates	530	(4,209)	(312)	-
Obligations sold (note 5)	(3,052)	-	-	-
Acquired obligations	-	2,820	-	2,211
Asset retirement obligations - end of year	114,276	123,643	8,758	9,609
Less:				
Current portion	(54,222)	(52,319)	-	-
Long-term liabilities held for sale	-	(3,137)	-	-
	<u>\$ 60,054</u>	<u>\$ 68,187</u>	<u>\$ 8,758</u>	<u>\$ 9,609</u>

The total undiscounted amount of the estimated cash flows to settle the above obligations is \$143,274 (2005 - \$154,519). The cash flows have been discounted using an inflation and credit adjusted risk-free rates ranging from 3.25% to 4.6% to determine fair value.

The timing of the reforestation payments is based on the Company's estimate of the amount of time required to attain free to grow status in a given area, which is generally between 12 to 15 years. Payments relating to landfill closure and site remediation costs are expected to occur at periods ranging up to 20 years.

**West Fraser Timber Co. Ltd.**  
Notes to Consolidated Financial Statements  
December 31, 2006 and 2005

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(figures are in thousands of Canadian dollars, except where indicated)

**11 Shareholders' equity**

Authorized share capital

10,000,000 Preferred shares, issuable in series, without par value

200,000,000 Common shares, without par value

20,000,000 Class B common shares, without par value

	<u>2006</u>		<u>2005</u>	
	<b>Number of shares issued</b>	<b>Amount</b>	<b>Number of shares issued</b>	<b>Amount</b>
Common	37,886,731	\$ 597,615	37,871,786	\$ 597,061
Class B common	4,885,206	491	4,885,206	491
<b>Total Common</b>	<u>42,771,937</u>	<u>598,106</u>	<u>42,756,992</u>	<u>597,552</u>
Retained earnings		1,641,311		1,268,811
Share purchase loans		(287)		(444)
		<u>\$ 2,239,130</u>		<u>\$ 1,865,919</u>

**Share capital transactions during 2006**

The Company issued 14,945 Common shares for \$554.

**Share capital transactions during 2005**

The Company issued 12,242 Common shares for \$527 and 500,000 Class B common shares in the amount of \$50 were exchanged for Common shares during the year.

**Rights and restrictions of Common shares**

Common shares and Class B common shares are equal in all respects except that each Class B common share may at any time be exchanged for one Common share.

**Dividends payable**

Dividends declared and unpaid at December 31, 2006 amounted to \$5,988 (2005 - \$5,986) and are included in accounts payable and accrued liabilities.

**Share purchase loans**

Share purchase loans receivable of \$287 (2005 - \$444) under the Company's management share purchase plan are included as a reduction of shareholders' equity. The loans are non-interest bearing, mature in 2008 and are secured by a pledge of 12,326 (2005 - 18,475) Common shares.

# West Fraser Timber Co. Ltd.

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

(figures are in thousands of Canadian dollars, except where indicated)

### Share option plan

The Company has a share option plan for its directors, officers and employees, under which it may grant up to 3,505,506 share options. The exercise price of a share option is the closing price of the Company's Common shares on the day preceding the grant date. The options vest at the earlier of retirement or 20% per year from the grant date and expire after 10 years.

A summary of the activity in the share option plan is presented below:

	2006		2005	
	Options	Weighted average exercise price (dollars)	Options	Weighted average exercise price (dollars)
Outstanding - beginning of year	1,913,305	\$ 33.68	1,866,348	\$ 30.10
Granted	330,200	41.19	313,030	51.56
Exercised	(43,421)	33.63	(266,073)	29.65
Expired/cancelled	(45,400)	44.50	-	-
Outstanding - end of year	2,154,684	\$ 34.60	1,913,305	\$ 33.68
Exercisable - end of year	1,389,076	\$ 30.27	1,143,602	\$ 28.94

The following table summarizes information about the share options outstanding at December 31, 2006:

Range of exercise prices (dollars)	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price (dollars)	Number of exercisable options	Weighted average exercise price (dollars)
\$21.08	334,143	4.0	\$ 21.08	334,143	\$ 21.08
\$27.61 - \$29.75	490,661	2.7	\$ 29.33	490,661	\$ 29.33
\$33.41 - \$35.54	562,650	5.7	\$ 33.44	412,610	\$ 33.44
\$38.90 - \$41.19	469,200	8.4	\$ 40.37	78,800	\$ 38.90
\$51.56	298,030	8.1	\$ 51.56	72,862	\$ 51.56
	2,154,684	5.7	\$ 34.60	1,389,076	\$ 30.27

# West Fraser Timber Co. Ltd.

## Notes to Consolidated Financial Statements

### December 31, 2006 and 2005

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#### Directors' deferred share unit plan

Under the DDSU, non-employee directors of the Company may elect to receive all or a portion of their fee for that fiscal year in the form of deferred share units which vest immediately. Units are redeemable, in cash or Common shares, only following resignation or retirement and must be redeemed by December 15 of the following year and in certain cases a shorter time period. As at December 31, 2006, there were 20,499 (2005 - 13,149) units outstanding.

## 12 Commitments

- a) In November 2006, the Company entered into an agreement to acquire 13 sawmills for approximately US\$325 million, subject to post closing adjustments. The transaction is expected to close in the first quarter of 2007.
- b) Operating leases

The Company is committed to payments under certain operating leases for equipment, land, buildings and office space. The payments required under these leases over the next five years amount to \$9,058 (2005 - \$9,202).

2007	\$	2,580
2008		2,105
2009		1,480
2010		1,172
2011		980
Thereafter		741
		741
	\$	9,058

- c) Product purchase and sale commitments

The Company has long-term purchase and sale contracts with annual minimum volume commitments. All contracts are at market prices and on normal business terms.

- d) Capital expenditures

Capital commitments at December 31, 2006 amounted to \$13,440 (2005 - \$47,417).

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**13 Employee future benefits**

The Company maintains non-contributory defined benefit and defined contribution pension plans covering a majority of its employees. The defined benefit plans provide pension benefits based on either length of service or earnings and length of service. The Company also provides group life insurance, medical and extended health benefits to certain employee groups.

The total pension expense for the Company's defined contribution pension plans is \$1,475 (2005 - \$2,103).

The status of the Company's defined benefit pension plans and other benefit plans, in aggregate, is as follows:

	<b>Pension plans</b>		<b>Other benefit plans</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Expense</b>				
Current service cost	\$ 31,167	\$ 25,849	\$ 1,095	\$ 1,004
Interest cost on earned benefit obligations	41,302	39,513	2,853	2,920
Actual return on plan assets	(96,589)	(62,799)	-	-
Actual actuarial loss (gain) on benefit obligations	32,869	73,291	(728)	4,134
Other	(87)	(93)	-	-
Expense before adjustments	8,662	75,761	3,220	8,058
Difference between expected return and actual return on plan assets	50,097	24,169	-	-
Difference between net actuarial (gain) loss recognized and actual (gain) loss on benefit obligations	(30,674)	(73,545)	893	(4,032)
Difference in other	320	187	460	460
Net expense	<u>\$ 28,405</u>	<u>\$ 26,572</u>	<u>\$ 4,573</u>	<u>\$ 4,486</u>
<b>Accrued benefit obligations</b>				
Projected benefit obligations - opening	\$ 752,000	\$ 653,108	\$ 54,924	\$ 48,773
Acquired (divested) plans	(11,995)	-	(1,026)	2,969
Current service cost	31,342	24,892	1,096	863
Interest cost	41,399	36,171	2,861	2,539
Benefits paid	(38,578)	(35,361)	(1,578)	(3,563)
Actuarial loss (gain) and other	32,869	73,190	(728)	3,343
Plan transfers and improvements	3,363	-	35	-
Projected benefit obligations - ending	<u>\$ 810,400</u>	<u>\$ 752,000</u>	<u>\$ 55,584</u>	<u>\$ 54,924</u>
<b>Plan assets</b>				
Fair value - opening	\$ 698,940	\$ 584,892	\$ -	\$ -
Divested plans	(11,465)	-	-	-
Actual return on plan assets	96,589	62,799	-	-
Contributions	37,653	86,601	1,578	3,563
Benefits paid	(38,578)	(35,361)	(1,578)	(3,563)
Plan transfers and improvements	347	-	-	-
Other	96	9	-	-
Fair value - ending	<u>\$ 783,582</u>	<u>\$ 698,940</u>	<u>\$ -</u>	<u>\$ -</u>

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	Pension plans		Other benefit plans	
	2006	2005	2006	2005
<b>Funded status of the plans</b>				
Surplus (deficit) - registered plans	\$ (28,016)	\$ (53,051)	\$ (55,584)	\$ (54,924)
- supplemental plans	1,198	(9)	-	-
	(26,818)	(53,060)	(55,584)	(54,924)
Unamortized net actuarial losses	48,456	68,472	4,924	5,926
Unamortized past service costs	4,427	1,895	-	-
Unamortized net transitional amount	(2,307)	(2,409)	2,763	3,223
Contributions after measurement date	5,744	6,521	-	-
Long-term liabilities held for sale	-	873	-	-
Net accrued benefit (liability) asset	\$ 29,502	\$ 22,292	\$ (47,897)	\$ (45,775)
<b>Represented by</b>				
Deferred pension (note 7)	\$ 35,634	\$ 20,760	\$ -	\$ -
Pension and other benefit plans (note 10)	(6,132)	659	(47,897)	(45,775)
Long-term liabilities held for sale (note 5)	-	873	-	-
	\$ 29,502	\$ 22,292	\$ (47,897)	\$ (45,775)

The significant actuarial assumptions used are as follows:

	Pension plans		Other benefit plans	
	2006	2005	2006	2005
To determine benefit obligations at end of year				
Discount rate	5.25%	5.25%	5.25%	5.25%
Expected rate of return on plan assets	7.00%	7.00%	n/a	n/a
Rate of increase in future compensation	3.25%	3.25%	n/a	n/a
To determine benefit expense (income) for the year				
Discount rate	5.25%	6.00%	5.25%	6.00%
Expected rate of return on plan assets	7.00%	7.00%	n/a	n/a
Rate of increase in future compensation	3.25%	3.75%	n/a	n/a

The Company funds health care benefit costs, shown under other benefit plans, on a pay-as-you-go basis. The actuarial assumptions are for extended health care cost increases of 10% per year for five years, grading down to 4.5% per year thereafter, with no increase in the medical services plan.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point increase or decrease in assumed health care cost trend rates would have the following effects for 2006:

	Increase	Decrease
Total of service and interest cost	\$ 720	\$ 711
Accrued benefit obligations	\$ 8,747	\$ 8,175

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**Assets**

The weighted-average asset allocations of the Company's defined benefit plans at the measurement date, by asset category, are as follows:

	<b>2006</b>	<b>2005</b>
Equity investments	61%	53%
Fixed income investments	35%	38%
Other investments	4%	9%
	100%	100%

**Actuarial valuations**

Actuarial valuations of the Company's pension plans are generally required every three years. The most recent valuations and the next scheduled valuations for the Company's principal defined benefit plans are as follows:

<b>Last actuarial valuation date</b>	<b>Scheduled valuation date</b>	<b>Benefit obligations</b>	<b>Fair value of assets</b>
December 31, 2003	December 31, 2006	3%	3%
December 31, 2004	October 1, 2006	2%	2%
December 31, 2004	December 31, 2007	49%	50%
December 31, 2005	December 31, 2006	4%	5%
December 31, 2005	December 31, 2008	42%	40%
		100%	100%

**14 Financial instruments**

a) Fair values

The recorded amounts for cash and short-term investments, accounts receivable, operating loans, accounts payable and accrued liabilities approximate fair values, based on their short-term maturities.

The fair value of the Company's long-term debt at December 31, 2006 was \$480,341 (2005 - \$617,540) based on rates currently available to the Company for long-term debt with similar terms and remaining maturities.

b) Credit risk

The Company sells its products to a variety of customers under various payment terms and therefore is exposed to credit risks. The Company has adopted policies and procedures designed to limit these risks.

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c) Currency risk

A significant portion of the Company's earnings is generated from sales denominated in U.S. dollars. The Company does not use forward exchange contracts to reduce its exposure to exchange rate movements, however, the Company has a significant portion of its long-term debt denominated in U.S. dollars.

**15 Restructuring and impairment charges**

During the year, the Company expensed \$37,631 related to a restructuring of the pulp mill in Hinton, Alberta. Of this amount, \$34,780 was for the writedown of property, plant, equipment and timber with the balance for other restructuring costs.

In 2005, the Company expensed \$7,715 related to the shut-down of a 50% owned sawmill. Of this amount, \$5,184 was charged to amortization expense and \$2,531 of other closure costs was charged to administration expense.

**16 Countervailing and antidumping duties**

On October 12, 2006, the Softwood Lumber Agreement ("SLA 2006") between the Canadian and U.S. governments came into effect. The terms include replacing the then existing countervailing and antidumping duties with a Canadian-imposed export tax, or a combination of a lower tax and quota, both of which may vary based on the price of lumber and the volume of shipments to the United States. The agreement required both parties to withdraw all litigation and the U.S. industry to waive their rights to file another case while the agreement is in effect. The SLA 2006 required the U.S. government to refund with interest all duties collected. The Company's share of the US\$1 billion to be paid to the U.S. government under the SLA 2006 is funded by a special charge of 18.06% on duties and interest up to October 12, 2006. The following amounts have been recorded in the financial statements related to duties and the SLA 2006:

	<b>2006</b>	<b>2005</b>
Duties and interest receivable included in accounts receivable	\$ 2,660	\$ -
Special charge included in accounts payable	\$ 122,386	\$ -
Duties expensed prior to the SLA 2006 coming into effect	\$ 61,432	\$ 151,431
Duty refund recorded in income - net of related special charge	(386,827)	-
Duty (refund) expense	\$ (325,395)	\$ 151,431
Interest income	\$ (50,032)	\$ -

The special charge payable includes amounts payable related to pre-2005 duties paid to International Paper under the terms of the agreement under which the Company acquired Weldwood of Canada Limited.

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**17 Interest expense**

	<b>2006</b>	<b>2005</b>
Long-term interest	\$ (34,569)	\$ (47,478)
Current interest expense - net	(3,023)	(946)
	<u>\$ (37,592)</u>	<u>\$ (48,424)</u>

**18 The Forestry Revitalization Plan (“FRP”)**

In 2003, the Government of B.C. (“Crown”) enacted the FRP which provided for changes to Crown forest policy and to the allocation of Crown timber tenures to licensees. The harvesting rights associated with replaceable tenures in excess of certain annual volumes were reduced by 20% and assets, such as roads and bridges in the affected areas, were also expropriated. The effect of the timber take-back was a reduction of approximately 1,275,000 m<sup>3</sup> of the Company’s existing allowable annual cut on replaceable tenures. The Company has received \$30,740 for the tenure reduction and certain related assets resulting in a gain of \$13,609.

**19 Other income (expense)**

	<b>2006</b>	<b>2005</b>
Foreign exchange gain (loss) - net	\$ 11,604	\$ (14,511)
Gain on asset sales	2,582	3,171
Rental income - net	1,205	1,490
Other - net	5,593	1,079
	<u>\$ 20,984</u>	<u>\$ (8,771)</u>

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**20 Income taxes**

The Company's effective tax rate is as follows:

	<b>2006</b>		<b>2005</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
Income taxes at statutory rates	\$ (178,057)	(34.1)	\$ (52,287)	(34.9)
Large corporations tax	-	-	(3,452)	(2.3)
Non-taxable amounts	20,624	4.0	(4,502)	(3.0)
Rate differentials between jurisdictions and on specified activities	8,751	1.6	8,833	5.9
Reduction in statutory income tax rates	33,106	6.4	9,518	6.4
Benefit of losses not previously recognized	3,079	0.6	2,477	1.6
Other	(11,359)	(2.2)	(2,884)	(1.9)
	<b>\$ (123,856)</b>	<b>(23.7)</b>	<b>\$ (42,297)</b>	<b>(28.2)</b>

The components of the future income taxes are as follows:

	<b>2006</b>	<b>2005</b>
Future income tax liabilities		
Property, plant, equipment and timber	\$ (378,182)	\$ (462,632)
Other	(16,450)	(11,466)
	<b>(394,632)</b>	<b>(474,098)</b>
Future income tax assets		
Asset retirement obligations	32,737	46,563
Post-retirement obligations	14,609	8,993
Loss carry-forwards	15,875	17,116
Other	18,968	23,789
	<b>82,189</b>	<b>96,461</b>
	<b>\$ (312,443)</b>	<b>\$ (377,637)</b>

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**21 Earnings per share**

Basic earnings per share are calculated based on earnings available to Common shareholders, as set out below, using the weighted average number of Common shares outstanding. Diluted earnings per share assume the exercise of options using the treasury stock method.

	<b>2006</b>	<b>2005</b>
<b>Earnings available to shareholders</b>	\$ 397,997	\$ 107,650
<b>Weighted average number of shares</b>		
Weighted average shares - basic	42,751,422	42,731,125
Share options - treasury stock method	375,924	556,334
Weighted average number of shares - diluted	43,127,346	43,287,459
<b>Earnings per share (dollars)</b>		
Basic	\$ 9.31	\$ 2.52
Diluted	\$ 9.23	\$ 2.49

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## 22 Segmented information

The segmentation of the Company's manufacturing operations into lumber, panels and pulp and paper is based on a number of factors, including similarities in products, production processes, and economic characteristics. The accounting policies of each segment are the same as those described in note 1.

### 2006

	Lumber		Panels		Pulp & paper		Corporate and other		Consolidated
Sales at market prices									
To external customers	\$	1,755.6	\$	475.1	\$	1,095.1	\$	-	\$ 3,325.8
To other segments		83.4		7.6		-		-	
	\$	1,839.0	\$	482.7	\$	1,095.1	\$	-	
EBITDA <sup>(1)</sup>	\$	518.0	\$	52.8	\$	122.8	\$	(11.6)	\$ 682.0
Amortization		117.6		39.7		91.0		3.6	251.9
Restructuring charge		-		-		37.6		-	37.6
Operating earnings (loss)		400.4		13.1		(5.8)		(15.2)	392.5
Interest income (expense) - net		29.5		(6.3)		(11.0)		0.2	12.4
Exchange loss on long-term debt		-		-		-		(0.7)	(0.7)
Gain on sale of power purchase agreement		2.2		8.4		51.2		-	61.8
Gain on sale of assets held for sale		21.7		-		-		-	21.7
Gain on timber take-back		13.6		-		-		-	13.6
Other income (expense)		13.8		0.4		(0.2)		7.0	21.0
Earnings (loss) before income taxes and non-controlling interest	\$	481.2	\$	15.6	\$	34.2	\$	(8.7)	\$ 522.3
Total capital employed <sup>(1)</sup>	\$	1,479.6	\$	422.3	\$	1,008.9	\$	410.5	\$ 3,321.3
Identifiable assets	\$	1,773.7	\$	466.2	\$	1,100.6	\$	677.9	\$ 4,018.4
Capital expenditures	\$	123.0	\$	19.9	\$	66.5	\$	2.2	\$ 211.6
<b>Sales by geographic area</b>									
Sales to external customers									
USA	\$	1,281.3	\$	150.9	\$	398.8	\$	-	\$ 1,831.0
Canada		355.1		314.0		84.6		-	753.7
Europe		-		-		116.8		-	116.8
Far East		119.1		10.2		307.9		-	437.2
Other		0.1		-		187.0		-	187.1
	\$	1,755.6	\$	475.1	\$	1,095.1	\$	-	\$ 3,325.8
<b>Property, plant, equipment and timber by geographic area</b>									
Canada								\$	2,042.8
USA									91.1
								\$	2,133.9

<sup>(1)</sup> **Non-GAAP measures:**

- EBITDA is defined as operating earnings plus amortization of property, plant, equipment and timber plus restructuring charge.
- Capital employed is defined as identifiable assets less current non-interest bearing liabilities at year-end.

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**2005**

	Lumber		Panels		Pulp & paper		Corporate and other		Consolidated
Sales at market prices									
To external customers	\$	2,020.9	\$	511.0	\$	1,044.8	\$	-	\$ 3,576.7
To other segments		86.0		5.0		-		-	
	\$	2,106.9	\$	516.0	\$	1,044.8	\$	-	
EBITDA <sup>(1)</sup>	\$	327.8	\$	65.4	\$	62.2	\$	(8.5)	\$ 446.9
Amortization		121.9		38.1		92.5		2.9	255.4
Operating earnings (loss)		205.9		27.3		(30.3)		(11.4)	191.5
Interest expense		(28.0)		(9.1)		(10.1)		(1.2)	(48.4)
Exchange gain on long-term debt		-		-		-		13.9	13.9
Gain on timber take-back		3.3		-		-		-	3.3
Other income (expense)		(0.4)		(0.4)		0.8		(8.9)	(8.9)
Earnings (loss) before income taxes and non-controlling interest	\$	180.8	\$	17.8	\$	(39.6)	\$	(7.6)	\$ 151.4
Total capital employed <sup>(1)</sup>	\$	1,762.9	\$	450.8	\$	976.2	\$	40.1	\$ 3,230.0
Identifiable assets	\$	1,938.9	\$	492.7	\$	1,081.3	\$	120.8	\$ 3,633.7
Capital expenditures	\$	147.4	\$	23.6	\$	46.6	\$	6.8	\$ 224.4
<b>Sales by geographic area</b>									
Sales to external customers									
USA	\$	1,460.3	\$	169.7	\$	378.8	\$	-	\$ 2,008.8
Canada		410.2		326.4		73.2		-	809.8
Europe		-		0.1		126.2		-	126.3
Far East		150.3		14.8		247.1		-	412.2
Other		0.1		-		219.5		-	219.6
	\$	2,020.9	\$	511.0	\$	1,044.8	\$	-	\$ 3,576.7

**Property, plant, equipment and timber by geographic area**

Canada							\$	2,127.5
USA								102.6
							\$	2,230.1

<sup>(1)</sup> **Non-GAAP measures:**

- EBITDA is defined as operating earnings plus amortization of property, plant, equipment and timber plus restructuring charge.
- Capital employed is defined as identifiable assets less current non-interest bearing liabilities at year-end.

