



2007 was a year of unprecedented challenges for the Canadian forest products industry. The rapidly strengthening Canadian dollar, the collapse of the U.S. housing market and the first full year of the softwood lumber agreement all had a significant, and negative, effect on the financial performance of West Fraser. Never before has the Company experienced such a quick and deep deterioration in the economics of its business. For the year, West



Fraser reported a loss of \$34 million or \$0.80 per share. We generated \$103 million of EBITDA and invested \$107 million in capital improvements at our mills. We ended the year with net debt of \$696 million and a debt to capital ratio of 25%. By any measure, 2007 was the most difficult year in the Company's 53-year history.

From the close of 2006 to the close of 2007, the Canadian dollar appreciated 15% against its U.S. counterpart. This has put enormous pressure on Canadian exporters who must attempt to offset the significant reduction to revenues through cost reductions and productivity improvements. Governments and labour must work urgently and cooperatively with industry to adjust to the new reality of the stronger Canadian currency.

Even as the U.S. economy stayed relatively strong throughout most of 2007, lumber prices continued to plummet as a result of a severe depression in the U.S. housing market. Housing starts fell from an annualized rate of 1.6 million units at December 2006 to an annualized rate of 1.0 million units at December 2007. Annualized housing starts have declined from a high in 2006 of 2.3 million units to 1.0 million units at the end of 2007. In addition, the inventory of unsold homes in the United States stood at approximately 10 months of supply at the end of 2007. It is generally accepted that a four month supply represents a balanced housing market. Clearly, we are in the midst of a painful and prolonged housing slump.

In addition, 2007 marked the first full year that the Canadian lumber industry operated under the new softwood lumber agreement with the United States. Under the terms of this agreement, western Canadian lumber producers paid a 15% export tax on all lumber shipped to the United States. This further eroded our sawmill operating margins.

West Fraser ships approximately 72% of its Canadian lumber production to the United States. With the continuing strength of the Canadian dollar and no sign yet that the U.S. housing market has bottomed out, our lumber and MDF businesses will continue to face severe economic pressure in the coming months. Fortunately, our Canadian mills are among the most modern and efficient in the industry, which positions us well to survive this current depression.

In 2007, plywood continued to be a bright spot as approximately 90% of West Fraser's plywood production was sold in Canada where a strong housing market and relatively good prices prevailed.

U.S. dollar-denominated prices for pulp, linerboard and kraft paper strengthened significantly during the year but the strengthening Canadian dollar considerably reduced these pricing gains. The newsprint market, on the other hand, continued to deteriorate throughout the year and Canadian newsprint producers took the full brunt of the strengthening Canadian dollar.

Our long-term goal has been to grow strategically in the solid wood products business while our operating philosophy has been to constantly improve and upgrade our existing plants and promote a frugal and cost-conscious culture, while maintaining a conservative balance sheet. This has allowed us to survive and prosper despite the severe economic downturns that we have experienced in the past and it is this approach that will allow us to emerge from the current severe downturn as a strong and growing company. Over the past several years our lumber production has increased dramatically both through major acquisitions and capacity

increases. This not only reflects our solid commitment to this business but also the growth opportunities that exist in spite of the severe business cycles. We believe this validates the strong and focused operating culture we have cultivated since our Company was founded in 1955.

2007 marked an exciting milestone in our development as we completed the acquisition of 13 sawmills in the southern United States, adding to our two existing mills in Louisiana and Arkansas. West Fraser is now a truly North American wood products company. We are one of North America's largest lumber producers with significant panel board and pulp and paper assets as well. Approximately one-third of our lumber production is now based in the United States. This is an important strategic step for West Fraser as it significantly increases our geographic, product and currency diversification. While lumber prices have declined precipitously since the completion of this acquisition at the end of March 2007, we firmly believe that when the lumber market recovers, as it inevitably will, West Fraser will be well positioned to take advantage of the upturn in lumber prices.

At the beginning of 2007, we set some ambitious goals for ourselves and, notwithstanding the difficult external economic pressures we faced, I am pleased to report that we have achieved or exceeded most of these goals.

First and foremost, we completed our U.S. acquisition at the beginning of the second quarter of 2007 and by the end of the year had virtually completed the integration of these operations with the rest of the Company. We have created a Southern Division headquartered in Memphis, Tennessee which includes a strong and cohesive group of very talented and committed employees. We have fully achieved the synergies that we targeted on closing and, through the extraordinarily hard work of our operations, systems, human resources and financial personnel, we have had a relatively seamless transition.

Second, we have made great strides in continuing to develop an even stronger safety culture throughout the Company. Recordable incidents were down significantly from the previous year and, most importantly, accident severity was drastically reduced. Employees throughout the organization are clearly engaged in our pursuit of continual improvement in health and safety.

Third, we set out at the beginning of the year to maintain or improve our operating advantage against our peer group in our core wood products business. We have accomplished this. We were disappointed however, that we failed to achieve our goal of full production from our new Quesnel sawmill within twelve months of start up.

In our bleached kraft pulp business we set a goal to close the performance gap with the industry leaders. We achieved this goal as well but we still have work to do to firmly establish our two kraft pulp mills as first quartile operations. As part of our efforts, we completed the restructuring of our Hinton pulp business during the second half of the year. We are now working hard to extract the full benefits of this restructuring through lower costs and higher productivity.

Finally, we set a goal of continual improvement in environmental performance throughout the Company. Our goal is to continually reduce our environmental footprint while building a larger and more profitable company. During the year we continued to reduce the affect our operations have on both air and water quality. In fact, we have made great progress in reducing our energy consumption and greenhouse gas emissions per unit of product produced. As an industry, we have more than achieved the Kyoto targets set in 1997.

In addition, we worked hard during the year to improve our record of sustainability and habitat preservation. Working with the B.C. and Alberta governments and other interested parties, we voluntarily deferred logging on large tracts of timberland to allow further evaluation of the impact of logging on caribou herds in these areas. We are committed to finding sustainable solutions to the many ways in which our operations affect the environment.

At the same time, West Fraser is committed to supplying our growing customer base with the high quality forest products they require. The products we make are the best environmental choices for the uses to which they are put. Our wood and paper products come from renewable and sustainable forests. They are re-useable and are bio-degradable. Studies confirm that wood is the best environmental choice for housing. Properly-managed forests make a beneficial contribution to the environment. And, finally, more and more of our energy needs will be met by cellulosic fuel from our forests. In West Fraser's case approximately 30% of our direct energy needs are now met through wood-based fuel technology. We believe that in a world coping with the effects of global warming and rapidly increasing energy needs, our industry offers great hope for a more sustainable future for all of us.

Over the coming months, West Fraser will continue to face serious economic challenges as turmoil continues in the U.S. housing market. We are fortunate, however, that our pulp and paper business is expected to continue to enjoy strong prices in the coming months which should partially offset the effects of depressed lumber prices on our overall profitability.

In every previous housing downturn, West Fraser has benefited from the fact that we went into the slowdown with modern and efficient plants, a low-cost structure and a strong balance sheet. Today is no different. While some of our newly-acquired U.S. sawmills need to be modernized and upgraded, the core of our business is strong, efficient and well capitalized.

We also have some of the best people in the business to move the Company forward. Our senior management team has an average of 20 years of service with West Fraser. They are experienced and committed and understand what it takes to manage the Company in the difficult circumstances that we find ourselves in today. Equally importantly, employees throughout the Company understand our business philosophy and buy into our low-cost culture.

Over the coming months, we will face some tough operating decisions as a result of the continuing deterioration in the U.S. housing market. As we have done many times in the past, we will rely on the competitive spirit, determination and tenacity of our outstanding employee group to navigate the Company through these treacherous economic times.

During the year, your Board of Directors has diligently analyzed the risks and opportunities the Company faced and consistently challenged the management team to be innovative and proactive in addressing these issues. The experience and advice they provide has been invaluable in moving the Company forward.

Finally, I would like to thank the more than 9,000 West Fraser employees for their continuing loyalty and commitment to West Fraser. Through their efforts, we will build an even stronger company for the future.



Henry H. Ketcham

Chair of the Board,
President & Chief Executive Officer