



In 2008, West Fraser recorded its worst financial performance in its 54 year history due to the continuing depression in North American housing starts and the deepening global recession. While this was the second consecutive year of negative earnings for our Company, our strong asset base, solid balance sheet and dedicated and experienced team of West Fraser employees allowed us to produce positive EBITDA and free cash flow in spite of the worst economic environment for our industry since the Great Depression.

One year ago we did not believe our industry could face another year as bad as 2007 had been. By the end of 2007 lumber prices had dropped to unsustainably low levels, the Canadian dollar had strengthened considerably and the entire wood products industry was losing cash. In past recessions a dramatic supply response would have occurred to return the lower-cost producers to, at a minimum, positive cash flow. But lumber supply was not being withdrawn from the market as fast as demand was dropping. So prices continued to fall.

At the beginning of 2008, few people anticipated the depths to which the housing market would fall, the downward spiral of the economy into a full-fledged global recession and, in September, the near collapse of the financial system and the freezing up of credit markets around the world. So, by the autumn of 2008 the rest of the world economy was falling into the same severe recession that the wood products business had been suffering through for the past two years.

Fortunately, West Fraser's exposure to the pulp and paper business, combined with a weakening Canadian dollar, provided us with modest profits and relatively strong cash flows in that business which helped to offset the losses in our solid wood products business. However, by midsummer pulp prices began declining in response to the slowing economy. By year-end pulp prices had dropped by about 25% and worldwide inventories of pulp were reaching historic highs. At the same time the housing market continued to weaken due to declining property values and increasing foreclosures. As a result, the inventory of unsold new homes in the United States reached a record level of thirteen months at the end of the year. We do not expect any sustained improvement in lumber prices until new home inventory levels begin to decline and more lumber supply is withdrawn from the market.

Over the years West Fraser has followed a business strategy which, we believe, allows us to prosper in the good times while always being prepared for the bad times. This strategy can be summarized as follows. First, we continually invest in our plants and equipment to ensure a low-cost operating structure. Second, we operate with a lean, flat and flexible management structure. Third, we have an incredibly talented and dedicated team of employees who live, breathe and promote our frugal cost control environment in good times and bad. And fourth, we try to maintain a solid and conservative balance sheet.

As a result of this strategy, we entered the current downturn with among the most modern and efficient wood products mills in the Canadian industry. We had invested heavily in our newly-acquired kraft pulp business to position it in the first or second quartile in North America. And we had extracted the cost synergies from the US sawmills that we acquired in 2007. We had not, however, made the capital expenditures required to reposition several of these higher cost US mills into first or second quartile operations. As a result, our Canadian wood products business performed well versus most of our competitors while several of our southern US sawmills underperformed during the year due to the lack of capital investment in these plants.

Our MDF business continues to operate in a challenging economic environment but we have modern, efficient, low-cost plants which should give us a competitive advantage in these difficult times.

And finally, we are pleased at the progress we are making in our pulp and paper business although we face an extremely challenging year in 2009 as industry fundamentals continue to deteriorate. On balance, we are comfortable with our competitive position in the industry and ended the year with a strong balance sheet after paying down \$122 million of debt and investing \$47 million in capital improvements.

In response to the rapid descent into recession in 2008, West Fraser, along with most other participants in our industry, reduced production at several of our mills in the U.S. and Canada. We reduced annualized lumber production in Canada by 671 MMfbm or 17% of capacity and in the United States by 674 MMfbm or 34% of capacity. We also reduced annualized production at our two mechanical pulp mills by 150,000 tonnes or 25% of capacity. In January 2009, we announced further production curtailments to try to stabilize markets and reduce inventories. In some cases, we are being forced to curtail operations at some of our best mills which have never had to take downtime before. This clearly reflects the unprecedented depths to which the lumber and mechanical pulp markets have dropped. We are extremely disappointed that we have had to respond to this economic crisis in a way that has so negatively impacted many of our employees.

But even in these very trying times, our West Fraser employees continue to respond positively and constructively. In 2008, we continued to improve productivity and costs at many of our mills. We successfully negotiated labour contracts at several of our mills which, we hope, will set the stage for improved results that will enhance the long-term viability of certain of these operations. And we have continued to make good progress in our never-ending goal to continually improve our safety performance throughout the organization. During such trying times, it is a testament to the commitment of our people that we continue to reduce accident frequency and accident severity in the Company. However, I'm sad to report that, notwithstanding the continuing progress we are making, we lost an experienced, dedicated and popular employee to a fatal accident in January 2009. Throughout our organization we must continue to dedicate ourselves to the pursuit of an accident-free workplace.

One of the main business challenges we continue to face is the mountain pine beetle epidemic that has spread through the Interior of British Columbia and, to a much lesser degree, Alberta. In British Columbia lumber yield and grade recovery continue to deteriorate as a result of the declining quality of the resource. We've made some progress in limiting the effects of the lower quality wood on our operations through technological improvements at some of our mills and through improved operating techniques. However, our results will continue to be negatively impacted by the effects of this infestation.

As a result of the epidemic in B.C., we expect the long-term sustained yield of the interior forest to drop substantially over the next decade. In Alberta we are hopeful that aggressive action by the industry and the provincial government combined with very cold weather early in the winter will have significantly reduced the threat of a full scale infestation in that province. Over the next several years we will continue to develop strategic options for dealing with the eventual reduction in harvest in British Columbia caused by the mountain pine beetle.

In 2008, we continued to improve our environmental performance. Over the past five years we have substantially reduced our greenhouse gas emissions and we have expanded our green energy production through the use of biomass. We continue to improve our air and water discharges and the Company actively participates in several government and industry committees which are working to reduce our carbon footprint.

In the forests we planted over 55 million trees in 2008. All of our timber tenures are third-party certified to the Sustainable Forestry Initiative standards and we continued to work with government and third-party interest groups to preserve and protect Mountain Caribou habitat in our operating areas. Our employees are actively engaged in the process of continual improvement in our environmental performance.



As we enter 2009, we are faced with another very challenging year. The credit markets are still frozen and consumer sentiment is the lowest it's been in years. Our challenge in this environment is to do what we do best: operate our plants efficiently, continue to find ways to reduce costs and improve margins and protect our balance sheet. This requires the combined effort of all our employees and I'm proud to say that, as usual, they have stepped up to the challenge. Throughout the organization our employees continue to give their commitment, loyalty and hard work to enhancing our competitive position in the industry. We are fortunate to have such an extraordinary work force. This is our true competitive advantage.

At the end of 2008, three long-time Vice-Presidents retired from the Company. Gary Townsend – President, Solid Wood Products – retired after 37 years with the Company. Gary ran our wood products division for twenty years and was responsible not only for building it into one of the largest and most competitive in the industry but also for further imbedding the unique culture our Company has enjoyed since its inception in 1955.

Bill LeGrow – Vice-President of Transportation and Energy – enjoyed a 27 year career with the Company and, due to his strong business skills, assumed a diverse portfolio of responsibilities including transportation, energy and the softwood lumber trade dispute negotiations.

Martti Solin – Executive Vice-President, Finance, Corporate Development and CFO - joined the Company in 1989 and, in addition to being a strong, forceful and experienced CFO, was the chief negotiator on many of the major acquisitions undertaken by the Company over the past two decades.

While we will sorely miss the contributions these three individuals have made to our Company, I'm glad to report that their responsibilities have been assumed by a group of talented and experienced leaders who will be instrumental in building our Company in the future.

Throughout the year, your Board of Directors has offered constructive guidance, critical analysis and thoughtful advice to our management team. The Board's active engagement in all aspects of our business adds a vital dimension to the decision-making process in our Company.

Finally, I want to acknowledge once again the outstanding contribution our employees make to the success of our Company every day of the year. Their loyalty to the Company and their commitment to the safe, high-productivity and low-cost culture that has been the hallmark of our Company for five decades is what will drive our success in the future.

**Henry H. Ketcham**  
Chairman, President and Chief Executive Officer