DRAGON PHARMACEUTICAL INC
Form 10QSB
August 14, 2006
U.S. Securities and Exchange Commission

Washington, D.C. 20549

Form 10-QSB

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934**

For the transition period from _____ to _____

Commission file number 0-27937

DRAGON PHARMACEUTICAL INC.

(Exact name of small business issuer as specified in its charter)

Florida	65-0142474
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

650 West Georgia Street, Suite 310

Vancouver, British Columbia

Canada V6B 4N9

(Address of principal executive offices)

(604) 669-8817

(Issuer s telephone number)

(Former address if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the (Exchange Act). Yes [ ]No [X]

Number of shares of common stock outstanding as of June 30, 2006: 62,878,004

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

DRAGON PHARMACEUTICAL INC.

AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS AT JUNE 30, 2006 AND DECEMBER 31, 2005

(UNAUDITED) Expressed in US Dollars

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DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS AT JUNE 30, 2006 AND DECEMBER 31, 2005

(UNAUDITED) Expressed in US Dollars

(Basis of Presentation Note 1)

ASSETS	Notes		June 30, 2006		December 31, 2005
CURRENT ASSETS					
Cash and cash equivalents	18	$	957,990	$	1,311,378
Restricted cash	10,18		806,844		3,327,829
Accounts receivable, net of allowances	2		5,512,168		4,352,236
Inventories, net	3		9,741,162		9,532,537
Prepaid expenses			1,258,573		1,199,941
Assets held for sale	7		16,186,063		8,270,429
Total Current Assets			34,462,800		27,994,350
PROPERTY AND EQUIPMENT, NET	4,9		61,703,011		61,153,955
OTHER ASSETS					
Intangible assets, net	6		2,745,471		2,984,994
Investments -cost			12,490		12,392
Goodwill			965,000		965,000
Total Other Assets			3,722,961		3,962,386
Assets held for sale	7		-		8,455,805
TOTAL ASSETS		$	99,888,772	$	101,566,496
Liabilities and Stockholders' Equity					
CURRENT LIABILITIES					
Accounts payable		$	4,921,393	$	2,397,833
Other payables and accrued liabilities	8		21,647,510		13,637,203
Loans payable short-term	9		19,181,915		13,479,554
Notes payable	10		806,844		3,327,829
Due to related party	11		62,585		61,993
Liabilities held for sale	7		11,825,348		8,464,387
Total Current Liabilities			58,445,595		41,303,095
LONG-TERM LIABILITIES					
Long term accounts payable	12		7,193,649		12,216,832
Loans payable long-term	9		215,642		9,515,851
Liabilities held for sale	7		-		5,700,941
Total Long-Term Liabilities			7,409,291		27,433,624
TOTAL LIABILITIES			65,854,886		68,736,719
COMMITMENTS AND CONTINGENCIES (Note 15)					
STOCKHOLDERS EQUITY					
Authorized: 200,000,000 common shares at par value of $0.001 each					
Issued and outstanding: 62,878,004 common shares			62,878		62,878
Additional paid-in capital			24,498,866		24,317,830
Retained earnings			5,872,408		5,099,891
Reserves			2,628,008		2,628,008

Accumulated other comprehensive income		995,655		750,102
Due from stockholders		(23,929)		(28,932)
Total Stockholders Equity		34,033,886		32,829,777
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	99,888,772	$	101,566,496

The accompanying notes are an integral part of these consolidated financial statements.

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DRAGON PHARMACEUTICAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005

(UNAUDITED) Expressed in US Dollars

	Note	Three Months Ended June 30, 2006
NET SALES	13	$ 13,889,5
COST OF SALES		11,494,7
GROSS PROFIT		2,394,72
OPERATING EXPENSES		
Selling expense		616,286
General and administrative expenses		1,364,92
Depreciation and amortization		236,399
Total Operating Expenses		2,217,61
INCOME (LOSS) BEFORE THE UNDERNOTED		177,111
OTHER INCOME (EXPENSE)		
Interest expense	12	(939,059
Other income	14(A),(B)	4,169
Funds released by Chinese Government Liquidator	14(C)	-
Total Other Income (Expenses)		(934,890
INCOME (LOSS) BEFORE TAXES		(757,779
		(109,677

INCOME TAX (EXPENSE) RECOVERY

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WEYERHAEUSER COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

For the twenty-six week periods ended June 25, 2006 and June 26, 2005

(Dollar amounts in millions)

(Unaudited)

	Consolidated		Weyerhaeuser		Real Estate and Related Assets	
	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005
Cash flows from operations:						
Net earnings (loss)	$ (266)	$ 659	$ (454)	$ 449	$ 188	$ 210
Noncash charges (credits):						
Depreciation, depletion and amortization	628	666	621	659	7	7
Deferred income taxes, net	(99)	(209)	(93)	(197)	(6)	(12)
Pension and other postretirement benefits expense (Note 5)	65	88	63	85	2	3
Share-based compensation expense (Note 3)	17	(4)	15	(4)	2	
Equity in income of affiliates and unconsolidated entities	(45)	(27)	(9)	(4)	(36)	(23)
Charges for litigation (Note 14)	2	30	2	30		
Charge for impairment of goodwill (Note 9)	749		749			
Charge for impairment of assets (Notes 7 & 8)	18		15		3	
Gain on sale of British Columbia Coastal Group (B.C. Coastal) operations (Note 15)		(64)		(64)		
Gain on previous timberland sales (Note 12)		(57)		(57)		
Loss on disposition of assets		1		1		
Foreign exchange losses (Note 10)	5		5			
Decrease (increase) in working capital, net of acquisitions:						
Receivables	(310)	(464)	(211)	(448)	(99)	(16)
Inventories, real estate and land	(334)	(265)	(9)	(111)	(325)	(154)
Prepaid expenses	(24)	(36)	(19)	(43)	(5)	7
Accounts payable and accrued liabilities	(117)	168	(285)	221	168	(53)
Purchase option deposits	(80)	(45)			(80)	(45)
Other	(42)	(2)	(34)	3	(8)	(5)
Net cash from operations	167	439	356	520	(189)	(81)
Cash flows from investing activities:						
Payments for property and equipment	(381)	(320)	(366)	(313)	(15)	(7)
Timberlands reforestation	(21)	(18)	(21)	(18)		
Acquisition of timberlands	(31)	(22)	(31)	(22)		
Acquisition of a business, net of cash acquired	(213)				(213)	
Net distributions from equity affiliates	13	19	1		12	19
Proceeds from sales of property, equipment and other assets	12	18	12	18		
Proceeds from sale of B.C. Coastal operations (Note 15)		1,107		1,107		
Intercompany advances			(387)	35	387	(35)
Other	4	(9)	4	(9)		

Net cash from investing activities	(617)	775	(788)	798	171	(23)
Cash flows from financing activities:						
Issuances of debt		1		1		
Notes, commercial paper borrowings and revolving credit facility, net	76	19	(49)	42	125	(23)
Cash dividends	(246)	(220)	(246)	(220)		
Payments on debt	(525)	(625)	(168)	(610)	(357)	(15)
Exercise of stock options	171	136	171	136		
Excess tax benefits from share-based payment arrangements (Note 3)	17		17			
Other	2	(7)	2	(7)		
Net cash from financing activities	(505)	(696)	(273)	(658)	(232)	(38)
Net change in cash and cash equivalents	(955)	518	(705)	660	(250)	(142)
Cash and cash equivalents at beginning of period	1,104	1,197	818	1,044	286	153
Cash and cash equivalents at end of period	$ 149	$ 1,715	$ 113	$ 1,704	$ 36	$ 11
Cash paid during the period for:						
Interest, net of amount capitalized	$ 272	$ 386	$ 272	$ 386	$	$
Income taxes	$ 269	$ 276	$ 269	$ 104	$	$ 172

See Accompanying Notes to Consolidated Financial Statements

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WEYERHAEUSER COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the thirteen and twenty-six week periods ended June 25, 2006 and June 26, 2005

(Unaudited)

Note 1: Basis of Presentation

The Consolidated Financial Statements include the accounts of Weyerhaeuser Company and all of its majority-owned domestic and foreign subsidiaries, and variable interest entities of which Weyerhaeuser Company or its subsidiaries are determined to be the primary beneficiary. All significant intercompany transactions and balances have been eliminated. Investments in and advances to unconsolidated equity affiliates over which the company has significant influence are accounted for using the equity method with taxes provided on undistributed earnings.

Certain of the Consolidated Financial Statements and Notes to Consolidated Financial Statements are presented in two groupings: (1) Weyerhaeuser, principally engaged in the growing and harvesting of timber and the manufacture, distribution and sale of forest products, and (2) Real Estate and Related Assets, principally engaged in real estate development and construction and other real estate related activities. The term company refers to Weyerhaeuser Company, all of its majority-owned domestic and foreign subsidiaries and variable interest entities of which Weyerhaeuser Company or its subsidiaries are determined to be the primary beneficiary. The term Weyerhaeuser refers to the forest products-based operations and excludes the Real Estate and Related Assets operations.

The accompanying unaudited Consolidated Financial Statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the company s financial position, results of operations, and cash flows for the interim periods presented. Except as otherwise disclosed in the Notes to Consolidated Financial Statements, such adjustments are of a normal, recurring nature. The Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission pertaining to interim financial statements; as such certain disclosures normally provided in accordance with accounting principles generally accepted in the United States have been omitted. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included in the company s Annual Report on Form 10-K for the year ended December 25, 2005.

Certain reclassifications of prior period balances have been made for consistent presentation with the current period. These reclassifications had no impact on net earnings (loss) or shareholders interest.

Note 2: Accounting Pronouncements

New Accounting Pronouncements

Accounting for Income Tax Uncertainties

The Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* (Interpretation 48), in June 2006. Interpretation 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* Interpretation 48 also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The company is required to adopt Interpretation 48 in the first quarter of fiscal year 2007. Management is still reviewing the requirements of Interpretation 48 and has not yet determined the effect on the Consolidated Financial Statements.

Accounting Pronouncements Implemented

Accounting for Share-Based Compensation

The company adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (Statement 123R) as of the beginning of fiscal year 2006. Statement 123R is a revision of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (Statement 123), and supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). Upon adoption, Statement 123R requires the fair value of employee awards issued, modified, repurchased or cancelled to be measured as of the grant dates. The resulting cost is then recognized in the statement of earnings over the required service period. See Note 3: Share-Based Compensation for additional information including the effects of adopting Statement 123R.

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Accounting for Inventory Costs

The company also adopted FASB Statement of Financial Accounting Standards No. 151, *Inventory Costs An Amendment of ARB No. 43, Chapter 4* (Statement 151) as of the beginning of fiscal year 2006. Statement 151 amends the guidance in Accounting Research Bulletin No. 43 (ARB No. 43), Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, Statement 151 requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current period charges regardless of whether they meet the criterion of so abnormal as stated in ARB No. 43. Additionally, Statement 151 requires that the allocation of fixed production overheads to the costs of conversions be based on normal capacity of the production facilities. The effects of adopting Statement 151 were immaterial to the company s financial position, results of operations or cash flows.

Note 3: Share-Based Compensation

The company s Long-Term Incentive Compensation Plan (the Plan) provides for the award of stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares and performance share units. The exercise price of stock options and stock appreciation rights granted under the Plan are required to be at market price on the date of grant. No more than 17 million shares plus up to 1,939,181 shares subject to outstanding awards under prior plans that cease to be subject to such awards, may be issued under the Plan. The aggregate number of shares that may be issued as grants other than stock options or stock appreciation rights may not exceed 3,400,000. Participants are eligible to receive in any one calendar year stock options or stock appreciation rights relating to a maximum of 500,000 shares, or restricted stock, restricted stock units, performance shares, performance share units or other equity grants aggregating a maximum of 200,000 shares. Each year the Compensation Committee of the Board of Directors (the Committee) establishes an overall pool of stock awards available for grant in any given year based on performance. For stock-settled awards, the company issues new stock into the marketplace and generally does not repurchase shares in connection with the issuance of new awards. Prior to 2006, only stock options and stock appreciation rights had been issued under the Plan. In 2006, the company also issued restricted stock units and performance share units under the Plan.

In December 2004, the FASB issued Statement 123R, which revises Statement 123 and supersedes APB 25. Statement 123R eliminates the alternative of using the intrinsic value method of accounting for share-based awards that was provided under APB 25. Under APB 25, the company generally did not recognize compensation expense related to the issuance of stock options; however, compensation expense was recognized related to changes in the intrinsic value of stock appreciation rights issued under the Plan. Statement 123R establishes a fair-value-based measurement of share-based awards and requires that the cost of these awards be recognized in the company s Consolidated Financial Statements. The cost is recognized in the Consolidated Statement of Earnings over the period from the date of grant to the date when the award is no longer contingent upon the employee providing additional service (the required service period). For awards that vest upon retirement, the required service period does not extend beyond the date an employee is eligible for retirement , including early retirement. For awards that continue to vest following job elimination as a result of restructuring or the closure or sale of a facility, the required service period does not extend beyond the date the position is eliminated. These situations can result in compensation expense being recognized over a period less than the stated vesting period.

The company adopted Statement 123R as of the beginning of fiscal year 2006, using the modified prospective transition method. Accordingly, prior period amounts have not been restated. Prior to adoption of Statement 123R, the company defined the past year as the service period and share-based employee compensation expense was recognized in the company s pro forma disclosures in accordance with Statement 123 as of the option grant dates. Therefore, under the modified prospective method, no additional compensation expense will be recognized in the company s Consolidated Statement of Earnings related to equity-classified awards issued prior to 2006, unless those awards are subsequently modified.

Share-based compensation expense (income) recognized in the first and second quarters of 2006 for all share-based awards was $21 million and ($4) million, respectively, which included a $6 million charge in the first quarter for the cumulative effect to revalue the liability for stock appreciation rights as of December 25, 2005, from the intrinsic value of the outstanding awards to the estimated fair value of the outstanding awards. Total compensation expense (income) recognized in the first and second quarters of 2005 for share-based awards was $2 million and ($6) million, respectively. The total income tax benefit recognized in the Consolidated Statement of Earnings for share-based awards in the first and second quarters of 2006 was $15 million and $5 million, respectively. There was no comparable tax benefit recognized in the first or second quarters of 2005. Statement 123R requires the benefits of tax deductions in excess of the compensation cost recognized for share-based awards to be classified as financing cash inflows rather than operating cash inflows, on a prospective basis on the Consolidated

Statement of Cash Flows. The company realized $13 million and $4 million in excess tax benefits from share-based payment arrangements in the first and second quarters of 2006, respectively, which is shown as Excess tax benefits from share-based payment arrangements on the Consolidated Statement of Cash Flows. As of June 25, 2006, there was approximately $39 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of approximately 2.9 years.

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The following table illustrates the effect on 2005 net earnings and net earnings per share as if the company had applied the fair value recognition provisions of Statement 123 to share-based employee compensation. For awards issued to prior to 2006, the company defined the prior year as the service period for purposes of applying the fair value recognition provisions of Statement 123. As a result, share-based employee compensation expense is reflected as of the option grant dates in the following table:

Dollar amounts in millions, except per share data	**Thirteen weeks ended June 26, 2005**	**Twenty-six weeks ended June 26, 2005**
Net earnings as reported	$ 420	$ 659
Less: incremental share-based employee compensation expense determined under fair-value-based method, net of related tax effects		(33)
Pro forma net earnings	$ 420	$ 626
Earnings per share:		
Basic as reported	$ 1.72	$ 2.70
Basic pro forma	$ 1.72	$ 2.57
Diluted as reported	$ 1.71	$ 2.69
Diluted pro forma	$ 1.71	$ 2.56

Disclosures for the thirteen and twenty-six week periods ended June 25, 2006, are not presented because the amounts are recognized in the Consolidated Financial Statements and disclosures reflecting what 2006 results would have been if the provisions of Statement 123 had been applied would not be comparable.

Stock Options

Stock option awards are granted with an exercise price equal to the market price of the company s stock at the date of grant. Stock option awards generally vest ratably over four years of continuous service and have 10-year contractual terms. The Committee has determined that awards will continue to vest following retirement for employees who have attained at least 10 years of service and are age 55 through 61. Awards will vest upon retirement for employees who have attained at least 10 years of service and are age 62 or older, or who retire at age 65 or older. For awards granted in 2006 and thereafter, the share-based compensation expense for individuals meeting the retirement eligibility requirements, or who will meet the age and service requirements within the four-year vesting period, is recognized over a required service period that is less than the stated four-year vesting period.

During the second quarter of 2006, the Committee issued a special stock option grant to selected executives and other key employees. These stock option awards vest at the end of a two-year continuous service period and have a contractual term of five years.

The fair value of each stock option award is estimated on the date of grant using a Black-Scholes based option valuation model that uses the assumptions noted in the following table. Expected volatilities are based on implied volatilities from traded options on the company s stock, historical volatility of the company s stock, and other factors. The company uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the output of a Monte-Carlo simulation and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve over a period matching the expected term in effect at the time of grant.

	Twenty-six weeks ended		
	June 25, 2006		June 26, 2005
Valuation Model Assumptions:	**5 year options**	**10 year options**	**10 year options**
Expected volatility	20.92%	24.50%	29.52%
Expected dividends	2.70%	2.86%	2.52%
Expected term (in years)	3.38	5.21	4.73
Risk-free rate	4.88%	4.60%	3.91%
Weighted average grant date fair value	$ 12.52	$ 14.98	$ 15.58

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A summary of stock option activity under the Plan as of June 25, 2006, and changes during the twenty-six weeks then ended is presented below:

Stock Options	Options (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 25, 2005	14,808	$ 58.15		
Granted	1,976	$ 70.26		
Exercised	(3,077)	$ 55.27		
Forfeited or expired	(43)	$ 61.18		
Outstanding at June 25, 2006	13,664	$ 60.54	7.16	$ (3)
Exercisable at June 25, 2006	7,031	$ 57.54	5.92	$ 19

The total intrinsic value of options exercised during the twenty-six weeks ended June 25, 2006, and June 26, 2005, was $51 million and $37 million, respectively.

Restricted Stock Units (RSUs)

The Plan provides for the award of RSUs, which are grants that entitle the holder to shares of the company s common stock as the award vests. The company issued its first grant of RSUs during the first quarter of 2006. RSUs generally vest ratably over four years of continuous service and are forfeited upon termination of employment, including retirement. The grant date fair value of the RSU awards is equal to the market price of the company s common stock on the date of grant.

A summary of the status of the company s nonvested RSU awards as of June 25, 2006, and changes during the twenty-six weeks then ended, is presented below:

Nonvested RSUs	Stock Units (in thousands)	Weighted-Average Grant-Date Fair Value
Nonvested at December 25, 2005		$
Granted	341	$ 69.78
Forfeited	(6)	$ 69.77
Nonvested at June 25, 2006	335	$ 69.78

Because RSUs were first issued in 2006, no grant date fair value information is provided for prior periods and there were no RSU shares vested as of June 25, 2006.

Performance Share Units (PSUs)

The Plan provides for the grant of PSUs to selected executives and other key employees. PSUs are grants that entitle the holder to shares of the company s common stock if required performance targets are met. The company issued PSU awards for the first time during the first quarter of 2006. Performance is based on a number of factors, including return on net assets, the company s cost of capital and selected peer group financial performance over a three-year period. Each PSU grant is associated with a target number of shares. The final number of shares to be issued under each PSU grant can range from zero to 200 percent of the target. Over the performance period, the number of shares of stock that are expected to be issued will be adjusted based on the probability of achievement of the performance target and final compensation expense will be recognized based on the ultimate number of shares issued. PSU payouts will be in shares of company stock after the end of the three-year period, subject to the terms applicable to such awards.

The fair value of the PSUs is equal to the market price of the company s common stock. In accordance with Statement 123R, the PSUs are remeasured to fair value at each reporting date as certain conditions necessary to establish a grant date for accounting purposes have not been met. The PSUs generally vest over the three-year performance period and share-based compensation expense is recognized over the performance period. If the relative performance goals are not met, no compensation cost will be recognized and any previously recognized compensation cost will be reversed.

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A summary of PSU activity under the Plan as of June 25, 2006, and changes during the twenty-six weeks then ended is presented below. Share unit quantities are based on target award levels.

Nonvested PSUs	Stock Units (in thousands)	Weighted-Average Grant-Date Fair Value	
Nonvested at December 25, 2005		$	
Granted	157	$	69.81
Forfeited	(3)	$	69.77
Nonvested at June 25, 2006	154	$	69.81

Because PSUs were first issued in 2006, no grant date fair value information is provided for prior periods and there were no PSU shares vested as of June 25, 2006.

Stock Appreciation Rights (SARs)

The Plan provides for cash-settled SARs to be granted as part of a compensation award. SARs are similar to stock options; however, upon exercise the employee receives the difference between the current market price of the company s common stock and the strike price of the SARs as a cash award and does not purchase the underlying stock. SARs are generally issued to employees outside of the United States. SARs are liability-classified awards and are remeasured to fair value at each reporting date.

The fair value of each SAR award is estimated on the date of grant and is remeasured at each reporting date using a Black-Scholes based option valuation model. The valuation assumptions are derived in the same manner as the assumptions for stock options. SAR awards generally vest ratably over four years of continuous service and have 10-year contractual terms. The Committee has determined that awards will continue to vest following retirement for employees who have attained at least 10 years of service and are age 55 through 61. Awards will vest upon retirement for employees who have attained at least 10 years of service and are age 62 or older, or who retire at age 65 or older. For awards granted in 2006 and thereafter, the share-based compensation expense for individuals meeting the retirement eligibility requirements, or who will meet the age and service requirements within the four-year vesting period, is recognized over a required service period that is less than the stated four-year vesting period.

The valuation assumptions noted in the following table represent the inputs used in the Black-Scholes valuation model for SARs granted during the twenty-six weeks ended June 25, 2006. Prior to the adoption of Statement 123R, the company s SAR liability was based on the intrinsic value of the outstanding SAR awards; as such, valuation assumptions are not applicable for the twenty-six weeks ended June 26, 2005. As of June 26, 2005, the intrinsic value of SARs granted during the twenty-six weeks then ended was $1.62 for each award.

Valuation Model Assumptions	Twenty-six weeks ended June 25, 2006
Expected volatility	24.68%
Expected dividends	3.32%
Expected term (in years)	5.16
Risk-free rate	5.24%
Weighted average fair value as of June 25, 2006	$ 10.29

A summary of SARs activity under the Plan as of June 25, 2006, and changes during the twenty-six weeks then ended is presented below:

SARs	Rights (in thousands)	Weighted-Average Exercise Price	Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 25, 2005	970	$ 58.92		
Granted	179	$ 69.72		
Exercised	(242)	$ 56.85		
Forfeited or expired	(7)	$ 62.53		
Outstanding at June 25, 2006	900	$ 61.59	7.30	$ (1)
Exercisable at June 25, 2006	390	$ 58.43	5.67	$ 1

The total intrinsic value of SARs settled during the twenty-six weeks ended June 25, 2006, and June 26, 2005, was $4 million and $3 million, respectively.

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Note 4: Net Earnings (Loss) Per Share

Basic net earnings (loss) per share is computed by dividing the net earnings (loss) for the period by the weighted average number of common and exchangeable shares outstanding during the period. Diluted net earnings (loss) per share is computed by dividing the net earnings (loss) for the period by the weighted average number of common and exchangeable shares outstanding, plus the effect of dilutive potential common shares outstanding during the period, calculated using the treasury stock method. Dilutive potential common shares include outstanding stock options, restricted stock units and performance share units. The components of basic and diluted earnings per share are as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions except per share data, shares in thousands	2006	2005	2006	2005
Earnings (loss) from continuing operations	$ 300	$ 291	$ (282)	$ 525
Earnings from discontinued operations	14	129	16	134
Net earnings (loss) available for common and exchangeable shareholders	$ 314	$ 420	$ (266)	$ 659
Weighted average outstanding shares of common and exchangeable stock (basic)	248,147	244,702	246,971	243,782
Dilutive effect of share-based awards	1,047	1,179		1,177
Common and exchangeable stock and stock equivalents (dilutive)	249,194	245,881	246,971	244,959
Basic earnings (loss) per share:				
Earnings (loss) per share from continuing operations	$ 1.21	$ 1.20	$ (1.15)	$ 2.15
Earnings per share from discontinued operations	0.06	0.52	0.07	0.55
Net basic earnings (loss) per share	$ 1.27	$ 1.72	$ (1.08)	$ 2.70
Diluted earnings (loss) per share:				
Earnings (loss) per share from continuing operations	$ 1.20	$ 1.19	$ (1.15)	$ 2.15
Earnings per share from discontinued operations	0.06	0.52	0.07	0.54
Net diluted earnings (loss) per share	$ 1.26	$ 1.71	$ (1.08)	$ 2.69

Options to purchase 1,972,793 shares were not included in the computation of diluted earnings per share for the thirteen week period ended June 25, 2006, because of their anti-dilutive effect. Performance share units with potential maximum awards of 308,802 shares were not included in the computation of diluted earnings per share for the thirteen week period ended June 25, 2006 due to performance targets not being satisfied at the end of the period.

Options to purchase 13,664,124 shares; performance share units with potential maximum awards of 308,802 shares; and restricted stock units of 335,333 shares were not included in the computation of diluted earnings (loss) per share for the twenty-six week period ended June 25, 2006, due to the company s net loss position. However, some or all of these shares may be dilutive potential common shares in future periods.

Options to purchase 4,500 shares were not included in the computation of diluted earnings (loss) per share for both the thirteen and twenty-six week periods ended June 26, 2005, because of their anti-dilutive effect.

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Note 5: Pension and Other Postretirement Benefit Plans

The company recognized net pension and other postretirement benefit expense of $34 million and $65 million in the thirteen and twenty-six week periods ended June 25, 2006, respectively, and $38 million and $88 million in the thirteen and twenty-six week periods ended June 26, 2005, respectively. The components of net periodic benefit costs are:

	Pension			
	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Service cost	$ 33	$ 29	$ 73	$ 73
Interest cost	64	54	145	135
Expected return on plan assets	(104)	(80)	(234)	(201)
Amortization of loss	5	6	12	16
Amortization of prior service cost	8	7	18	18
Loss due to closure, sale, plan termination and other	2	1	2	1
	$ 8	$ 17	$ 16	$ 42

	Other Postretirement Benefits			
	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Service cost	$ 6	$ 5	$ 12	$ 11
Interest cost	13	12	26	27
Amortization of loss	9	6	15	13
Amortization of prior service cost	(2)	(2)	(4)	(5)
	$ 26	$ 21	$ 49	$ 46

The company contributed $30 million to its Canadian pension plans in the twenty-six weeks ended June 25, 2006, and expects to contribute a total of approximately $52 million to its Canadian pension plans in 2006. The company does not expect to make or be required to make any contributions to its U.S. pension plans during 2006.

Note 6: Comprehensive Income (Loss)

The company s comprehensive income (loss) is as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
Dollar amounts in millions	June 25,	June 26,	June 25,	June 26,

	2006	2005	2006	2005
Net earnings (loss)	$ 314	$ 420	$ (266)	$ 659
Other comprehensive income (expense):				
Foreign currency translation adjustments	47	(21)	52	12
Net derivative gains (losses) on cash flow hedges, net of tax	(12)	11	(35)	14
Reclassification of net gains on derivatives, net of tax	(3)	(8)	(9)	(7)
Comprehensive income (loss)	$ 346	$ 402	$ (258)	$ 678

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Note 7: Charges for Restructuring

Weyerhaeuser charges for restructuring include the following costs recognized in connection with business restructuring and overall cost reduction efforts:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Asset impairment charges	$ 13	$	$ 13	$
Termination benefits	4	4	6	5
Other restructuring costs	1		2	4
Reversal of restructuring charges recorded in prior periods			(3)	
	$ 18	$ 4	$ 18	$ 9

The charges recognized in 2006 were primarily related to the restructuring of the Containerboard, Packaging and Recycling business model.

At June 25, 2006, Weyerhaeuser s accrued liabilities include approximately $6 million of severance accruals related to restructuring charges recognized from 2005 through June 25, 2006. These accruals are associated with the termination of approximately 100 employees that have not yet occurred.

Note 8: Charges for Closure of Facilities

Weyerhaeuser incurred the following charges for the closure of facilities:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Asset impairment charges	$ 1	$	$ 2	$
Termination benefits	2	1	2	3
Other closure costs	14	2	18	5
Reversal of closure charges recorded in prior periods			(4)	
	$ 17	$ 3	$ 18	$ 8

The charges recognized in 2006 related primarily to the closure of two packaging facilities and costs associated with the wind down of the pulp and paper operations in Prince Albert, Saskatchewan.

Other closure costs include costs of dismantling and demolition of plant and equipment, gain or loss on disposition of assets, environmental clean-up and general costs to wind down operating facilities.

Changes in accrued severance during the twenty-six weeks ended June 25, 2006, were as follows:

Dollar amounts in millions	**Twenty-six weeks ended June 25, 2006**
Accrued severance as of December 25, 2005	$ 75
Charges	2
Payments	(24)
Reversal of severance charges recorded in prior periods	(4)
Other adjustments	1
Accrued severance as of June 25, 2006	$ 50

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Note 9: Goodwill

The following table provides a reconciliation of changes in the carrying amount of goodwill during 2006:

Dollar amounts in millions	Timberlands	Wood Products	Cellulose Fiber & White Papers	Containerboard, Packaging & Recycling	Corp & Other	Total
Balance as of December 25, 2005	$ 40	$ 798	$ 857	$ 1,275	$ 12	$ 2,982
Impairment of goodwill			(749)			(749)
Effect of foreign currency translation adjustments		10				10
Balance as of June 25, 2006	$ 40	$ 808	$ 108	$ 1,275	$ 12	$ 2,243

The company announced on April 26, 2006, that it is considering alternatives for its fine paper business that range from continuing to hold and operate the assets to a possible sale or other disposition. Based on an evaluation of the value of assets and liabilities within the fine paper reporting unit, the company believes that the implied net value of fine paper goodwill is zero. The company recognized an estimated charge of $746 million in the first quarter of 2006 and recognized an additional $3 million charge in the second quarter of 2006 for the impairment of the goodwill associated with the fine paper reporting unit.

Note 10: Other Operating (Income) Costs, Net

Other operating (income) costs, net, are an aggregation of both recurring and occasional income and expense items which fluctuate from period to period. Weyerhaeuser s other operating (income) costs, net, include the following (income) and expenses:

	Thirteen weeks ended		Twenty-six weeks ended	
Dollar amounts in millions	June 25, 2006	June 26, 2005	June 25, 2006	June 26, 2005
Gain on previous timberlands sales (Note 12)	$	$ (57)	$	$ (57)
Loss (gain) on disposition of assets	1	(3)		(4)
Charges for litigation (Note 14)		18	2	30
Foreign exchange (gains) losses	(21)	13	5	
Other, net	(3)	(11)		
	$ (23)	$ (40)	$ 7	$ (31)

Foreign exchange transaction gains and losses result from changes in exchange rates, primarily related to Weyerhaeuser s Canadian and New Zealand operations.

Note 11: Income Taxes

The company recognized goodwill impairment charges of $749 million in the twenty-six weeks ended June 25, 2006, which are not deductible for income tax purposes and represents a permanent book-tax difference. As a result, no tax benefit has been recognized for the goodwill impairment charge. The company has recognized income tax expense on year-to-date 2006 pretax book income, excluding the goodwill impairment charge, at an effective income tax rate of 34.0 percent.

During the second quarter of 2006, the company recognized the following discrete items: a $12 million income tax benefit related to a change in Texas state income tax law, an $18 million income tax benefit related to a reduction in the Canadian federal income tax rate and an $18 million income tax benefit related to a deferred tax adjustment associated with the Medicare Part D subsidy.

The American Jobs Creation Act (AJCA) became law in October 2004. The AJCA includes a deduction of 85 percent of certain foreign earnings that are repatriated, as defined by the AJCA. Based on this legislation and 2005 guidance by the Department of Treasury, the company repatriated $1.1 billion of foreign earnings in July 2005. A charge of $44 million related to the planned repatriation was accrued in the second quarter of 2005 and is included in income taxes (from continuing operations) in the accompanying Consolidated Statement of Earnings.

Note 12: Consolidation of Variable Interest Entities

The company consolidates variable interest entities of which Weyerhaeuser Company or its subsidiaries are determined to be the primary beneficiary.

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Weyerhaeuser consolidates the assets and liabilities of buyer-sponsored special purpose entities and the monetization special purpose entities (collectively SPEs) related to previous significant sales of nonstrategic timberlands. However, because the SPEs are separate and distinct legal entities from the company, the assets of the SPEs are not available to satisfy the liabilities and obligations of the company and the liabilities of the SPEs are not liabilities or obligations of the company. During the second quarter of 2005, following a final determination regarding the interpretation of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities Interpretation of ARB No. 51* (Interpretation 46R), gains on sales of nonstrategic timberlands that had been previously deferred were recognized in income, resulting in a $57 million pretax gain on previous timberlands sales which is included in other operating costs in the Consolidated Statement of Earnings.

Assets of the buyer-sponsored SPEs are invested in restricted bank financial instruments of $909 million as of both June 25, 2006, and December 25, 2005. The monetization SPEs had long-term debt of $757 million as of June 25, 2006, and $756 million as of December 25, 2005. The monetization SPEs are exposed to credit-related losses in the event of nonperformance by the banks, but the company does not expect the banks to fail to meet their obligations.

The company s real estate development subsidiaries enter into options to acquire lots at fixed prices in the ordinary course of business, primarily for the purpose of building single-family homes. In addition, a subsidiary in the Real Estate and Related Assets segment provides subordinated financing to third-party developers and homebuilders. Both fixed-price purchase options and subordinated financing constitute variable interests under Interpretation 46R. At June 25, 2006, the company s real estate subsidiaries have consolidated seven entities under Interpretation 46R, with estimated assets of $126 million and estimated liabilities of $102 million. At December 25, 2005, the company had consolidated five entities under Interpretation 46R with estimated assets of $76 million and estimated liabilities of $62 million. As of June 25, 2006, the company s real estate development subsidiaries have 11 lot option purchase agreements entered into prior to December 31, 2003, with deposits of approximately $42 million at risk. After exhaustive efforts, the company has not been able to obtain the information necessary to determine whether or not it is required to consolidate any of these entities under Interpretation 46R. The total amount that would be paid under these purchase options, if fully exercised, is approximately $156 million. In addition, as of June 25, 2006, the company s real estate development subsidiaries have 18 lot option purchase agreements with entities created after December 30, 2003, with deposits of approximately $28 million at risk, where the company is not the primary beneficiary and is not required to consolidate the entities. The total amount that would be paid under these option purchase agreements, if fully exercised, is approximately $307 million. One of the company s real estate subsidiaries has approximately $14 million in subordinated loans at risk at June 25, 2006, in 36 variable interest entities.

Note 13: Inventories

Weyerhaeuser inventories are comprised of the following:

Dollar amounts in millions	**June 25, 2006**	**December 25, 2005**
Logs and chips	$ 100	$ 144
Lumber, plywood, panels and engineered lumber	472	416
Pulp and paper	386	435
Containerboard and packaging	236	232
Other products	230	196
Materials and supplies	487	476
	$ 1,911	$ 1,899

Note 14: Legal Proceedings, Commitments and Contingencies

Legal Proceedings

Hardboard Siding Claims. In June 2000, the company entered into a nationwide settlement of hardboard siding class action cases and recognized a charge of $130 million before taxes to cover the estimated cost of the settlement and related claims.

The settlement class consists of all persons who own or owned structures in the United States on which the company s hardboard siding had been installed from January 1, 1981 through December 31, 1999. This is a claims-based settlement, which means the claims will be paid as submitted over a nine-year period. An independent adjuster reviews claims submitted and determines payment under the terms of the settlement agreement. Reserves for future claims settlements relating to hardboard siding cases require judgments regarding projections of future claims rates and amounts. At the end of the second quarter of 2006, the company had approximately $51 million in reserves remaining for hardboard siding claims. The company believes the reserve balances established for these matters are adequate, but is unable to estimate at this time the amount of additional charges, if any, that may be required for these matters in the future.

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The following table presents an analysis of the claims activity related to the hardboard siding class action cases:

	Twenty-six weeks ended June 25, 2006	Fifty-two week periods 2005	2004
Number of claims filed during the period	580	765	1,740
Number of claims resolved	650	640	2,990
Number of claims unresolved at end of period	635	705	580
Number of damage awards paid	225	270	1,140
Average damage award paid	$ 4,330	$ 4,100	$ 2,790

The lower average damage award paid in 2004 was due primarily to a lower number of awards for multi-family structures in 2004 than in 2005 or 2006.

The company has received $52 million in recoveries from its insurance carriers by way of negotiated settlements.

The company currently has no litigation pending with any person or entity that has opted out of the settlement. Individuals and entities that have opted out of the settlement may file lawsuits against the company in the future.

Linerboard Antitrust Litigation. In May 1999, two civil antitrust lawsuits were filed against the company in U.S. District Court, Eastern District of Pennsylvania. Both suits named as defendants several other major containerboard and packaging producers. The complaint in the first case alleged the defendants conspired to fix the price of linerboard which increased the price of corrugated containers. The complaint in the second case alleged that the company conspired to manipulate the price of linerboard and thereby the price of corrugated sheets. The class period for both suits was October 1993 through November 1995.

Two lawsuits were settled and a pretax charge of $23 million was recognized in the third quarter of 2003. Approximately 165 members of the classes opted out of the class and filed thirteen lawsuits against the company and other producers. The company settled three of the lawsuits and recognized a pretax charge of $12 million in the first quarter of 2005. The company settled all but one of the remaining opt-out cases and recognized a pretax charge of $38 million in the fourth quarter of 2005. The company resolved the remaining opt-out case in the second quarter of 2006 for an immaterial amount.

In March 2004, La Cie McCormick Canada Company filed a class action lawsuit in Superior Court of Justice, in Ontario, Canada against the company and other linerboard manufacturers on behalf of all Canadians who purchased corrugated products, including sheets and containers and/or linerboard, during the period of time from 1993 to at least the end of 1995. The allegations mirrored the allegations in the U.S. cases. In February 2006, the parties reached an agreement to settle the lawsuit for an immaterial amount. The court approved the settlement in the second quarter of 2006.

Alder Antitrust Litigation. In December 2000, a lawsuit was filed against the company in U.S. District Court in Oregon (the Initial Alder Case) alleging from 1996 to the present the company had monopoly power or attempted to gain monopoly power in the Pacific Northwest market for alder logs and finished alder lumber. A jury verdict of trebled damages of $79 million was appealed to the U.S. Court of Appeals for the Ninth Circuit where the decision was upheld. In September 2005, the company asked for discretionary review of the Initial Alder Case by the U.S. Supreme Court. In June 2006, the Supreme Court accepted review of the Ninth Circuit opinion. Oral argument has not been set.

In January 2005, the company received a copy of a complaint in equity filed in U.S. District Court in Oregon to set aside the judgment in the Initial Alder Case on behalf of a plaintiff who did not prevail in the trial. It alleged a fraud was committed on the court and requested judgment against the plaintiff be vacated and a new trial set on plaintiff s claim of monopolization of the alder sawlog market. Trebled damages of $20 million were alleged. The U.S. District Court stayed this matter until the U.S. Supreme Court takes final action in the Initial Alder Case. The company denies the allegations in the complaint and intends to vigorously defend the matter.

In June 2003, Washington Alder filed an antitrust lawsuit against the company in U.S. District Court in Oregon alleging monopolization of the alder log and lumber markets and seeking trebled damages of $36 million and divestiture of the company s Northwest Hardwoods Division and alder sawmills in Oregon, Washington and British Columbia. A jury verdict of trebled damages of $16 million was appealed to the U.S. Court of Appeals for the Ninth Circuit. After oral argument in November 2005, the matter was stayed pending a final disposition by the U.S. Supreme Court of the Initial Alder Case.

In 2005 the company settled similar lawsuits filed against the company by five hardwood mill owners in the U.S. District Court in Oregon. A pretax charge of $18 million was recognized in the second quarter of 2005.

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In April 2004, a civil class action antitrust lawsuit was filed against the company in U.S. District Court in Oregon claiming that as a result of the company s alleged monopolization of the alder sawlog market in the Pacific Northwest as determined in the Initial Alder Case, the company monopolized the market for finished alder and charged monopoly prices for finished alder lumber. In December 2004, the Judge issued an order certifying the plaintiff as a class representative for all U.S. purchasers of finished alder lumber between April 28, 2000, and March 31, 2004, for purposes of awarding monetary damages. The company denies the allegations in the complaint and intends to vigorously defend the matter. In February 2005, class counsel notified the court that approximately 5 percent of the class members opted out of the class action lawsuit. The company has no litigation pending with any entity that has opted out of the class, but it is possible that entities who have opted out may file lawsuits against the company in the future. The case was stayed in the fourth quarter of 2005 pending the U.S. Supreme Court entering a final opinion in the Initial Alder Case.

As of June 25, 2006, the company has reserves accrued in the amount of $95 million. While the company believes the reserve established for the alder antitrust litigation is adequate, the company is unable to estimate what additional charges, if any, may be required in the future, because of the uncertainties surrounding the litigation process.

OSB Antitrust Litigation. A consolidated lawsuit was filed in U.S. District Court in Pennsylvania in 2006 seeking class action status for persons and entities who purchased oriented strand board (OSB) directly from Weyerhaeuser, Louisiana-Pacific, Georgia-Pacific, Potlatch, Ainsworth Lumber, Norbord and J.M. Huber Corp. between June 2002 through the present. The lawsuit alleges the defendants conspired to fix and raise OSB prices in the United States during the class period and as a result, class members paid artificially inflated prices for OSB during that period. Additional lawsuits have also been filed and have been consolidated in the same court for discovery purposes on behalf of indirect purchasers of OSB in different states that have laws permitting such actions on behalf of indirect purchasers. No specific damage amounts have been claimed. The company has not established a reserve for this matter and is unable to estimate at this time the amount of charges, if any, that may be required in the future.

Paragon Trade Brands, Inc. Litigation. In 1999, the Equity Committee (Committee) in the Paragon Trade Brands, Inc. (Paragon), bankruptcy proceeding commenced an adversary proceeding against the company in U.S. Bankruptcy Court for the Northern District of Georgia asserting the company breached certain warranties in agreements between Paragon and the company connected with Paragon s public offering of common stock in February 1993. The Committee sought to recover damages sustained by Paragon in two patent infringement cases, one brought by Procter & Gamble and the other by Kimberly-Clark. In June 2002, the Bankruptcy Court held the company liable for breaches of warranty. In the second quarter of 2005, the Bankruptcy Court imposed damages of approximately $470 million. The company appealed the liability and damages determinations to the U.S. District Court for the Northern District of Georgia and posted a bond of $500 million. Oral argument on the company s appeal was heard the second quarter of 2006 and the company is currently awaiting a decision from the court. The company has not established a reserve for this matter because, based upon the information currently available to the company, including management s belief that an adverse result is not probable because the company will prevail on appeal, management believes the requirements of Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (Statement 5), for establishing a reserve in this matter have not been met. However, there is no guarantee that management will not determine in the future that a charge for all or a portion of any damage award is required. Any such charge could materially and adversely affect the company s results of operations for the quarter or the year in which such a charge may be recognized.

Other Litigation. The company is party to other matters generally incidental to its business in addition to the matters described above.

Summary. Although the final outcome of any legal proceeding is subject to a great many variables and cannot be predicted with any degree of certainty, management currently believes that adequate reserves have been established for probable losses from litigation when the amounts could be reasonably determined. Management further believes that the ultimate outcome of these legal proceedings could materially adversely affect results of operations, cash flows or financial condition in any given quarter or year, but will not have a material adverse effect on the company s long-term results of operations, cash flows or financial position.

Countervailing and Anti-Dumping Duties

Softwood Lumber Imported into the United States from Canada

In April 2001, the Coalition for Fair Lumber Imports (Coalition) filed two petitions with the U.S. Department of Commerce (Department) and the International Trade Commission (ITC) claiming that production of softwood lumber in Canada was being subsidized by Canada and that imports from Canada were being dumped into the U.S. market (sold at less than fair value). The Coalition asked that countervailing duty (CVD) and anti-dumping (AD) tariffs be imposed on softwood lumber imported from Canada.

In March 2002, the Department confirmed its preliminary finding that certain Canadian provinces were subsidizing logs by failing to collect full market price for stumpage. The Department established a final CVD rate of 18.79 percent. In the AD proceedings, the Department found that the six Canadian manufacturers examined, including the company, were engaged in sales at less than fair value and set cash deposit rates ranging from 2.18 percent to 12.44 percent. The company s deposit rate was set at 12.39 percent for AD tariffs. Because of statutory limitations that affected timing, the bonds covering duties following the preliminary determinations were released by the United States. The resulting reversal of accrued expenses was included in earnings during 2002.

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In May 2002, the ITC confirmed its earlier ruling that U.S. industry is threatened by subsidized and dumped imports and the company began making cash deposits relating to the CVD and AD actions. In June 2003, the Department began the process of the annual reviews to determine the final duty rates under both CVD and AD for annual periods commencing with the period from May 22, 2002, through March 31, 2003, for CVD and through April 30, 2003, for AD. The annual review process will be conducted covering successive one-year periods for five years. In 2007, both the CVD duty and AD orders will be automatically reviewed in a sunset proceeding to determine whether dumping will continue or a countervailing subsidy is likely to recur if the relevant order were to be revoked. As a result of administrative determinations and the first and second annual administrative reviews, the combined CVD and AD rate charged on Weyerhaeuser shipments of Canadian softwood lumber into the United States was reduced from 31.18 percent to 24.36 percent effective for the first quarter of 2005, and from 24.36 percent to 13.13 percent effective for the first quarter of 2006.

The CVD and AD tariffs and the allegations of material injury, subsidy and dumping and the distribution process under the Byrd Amendment are currently under review and challenge in several forums, including NAFTA panels, the ITC, the U.S. Court of International Trade and the WTO. Although these proceedings remain open, a settlement has been announced that is expected to resolve the outstanding issues.

In early July 2006, the Canadian and U.S. governments announced a final settlement to the long-standing dispute. The key provisions include: disposing of the deposits, imposition of export measures in Canada, and addressing long-term policy reform. However, the agreement requires 95 percent of Canadian industry to formally support the measure in order for it to be implemented. Enabling legislation must also pass the Canadian Parliament and that is not expected to be addressed until Parliament returns in late September. The U.S. and Canadian governments are insisting that the deal is final and they will not reopen it. The company continues to work with the stakeholders on both sides of the border to see that a final settlement is implemented. The settlement would return 80 percent of the deposits to the company s Canadian subsidiaries.

Through June 2006, the company has paid a cumulative total of $364 million in CVD and AD duty deposits and $22 million in related costs on softwood lumber the company has imported into the United States from Canada. The deposits made against the CVD and AD duties have been recognized as sales deductions in the consolidated statement of earnings. It is difficult to predict the net effect final duties will have on the company. In the event that final rates differ from the depository rates, ultimate charges may be higher or lower than those recorded to date. The company is unable to estimate at this time the amount of additional charges or reversals that may be necessary for this matter in the future.

Environmental Matters

In late 2002, the Environmental Protection Agency (EPA) issued a notice of violation (NOV) for alleged violations of the Clean Air Act at the company s Hawesville, Kentucky, pulp and paper mill. The company settled the matter and agreed to pay a penalty of approximately $150,000.

In December 2005, the Ohio Attorney General s Office notified Weyerhaeuser that it plans to initiate a Clean Air Act enforcement action against Weyerhaeuser Company Packaging, Inc. (a former subsidiary of the company) arising out of its operation of corrugated container manufacturing plants in Valley View and Bedford Heights, Ohio. The Attorney General s Office has indicated that it plans to request injunctive relief and approximately $500,000 in civil penalties, of which a portion could be contributed to supplemental environmental projects identified by the State of Ohio EPA (Ohio EPA). Weyerhaeuser has been discussing resolution of the issue with Ohio EPA and the Attorney General s Office.

The company is also a party to various proceedings relating to the cleanup of hazardous waste sites under the Comprehensive Environmental Response Compensation and Liability Act, commonly known as Superfund, and similar state laws. The EPA and/or various state agencies have notified the company that it may be a potentially responsible party with respect to other hazardous waste sites as to which no proceedings have been instituted against the company. As of the end of the second quarter of 2006, the company has established reserves totaling $30 million for estimated remediation costs on all of the approximately 71 active sites across its operations. Environmental remediation reserves totaled $29 million at the end of 2005. The increase in environmental remediation reserves reflects the incorporation of new information on all sites concerning remediation alternatives, updates on prior cost estimates and new sites, and the costs incurred to remediate these sites during this period. The company accrued remediation costs of $6 million and $2 million in the first twenty-six weeks of 2006 and 2005, respectively. The company incurred remediation costs of $5 million and $3 million in the first twenty-six weeks of 2006 and 2005, respectively, and charged these costs against the reserve. Based on currently available information and analysis, the company believes that it is reasonably possible that costs associated with all identified sites may exceed current accruals by up to $70 million, which may be incurred over several years. This estimate of the upper end of the range of reasonably possible additional costs is much less certain than the estimates upon which accruals are currently based, and utilizes assumptions less favorable to the company among the range of reasonably possible outcomes. In estimating both its current accruals for environmental remediation and the possible range of additional future costs, the company has assumed that it will not bear the entire cost of remediation of every site to the exclusion of other known potentially responsible parties who may be jointly and severally liable. The ability of other potentially responsible parties to participate has been taken into account, generally based on each party s financial condition and probable contribution on a per-site basis. No amounts have been recorded for potential recoveries from insurance carriers.

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The company has not recognized a liability under FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations an Interpretation of FASB Statement No. 143*, for certain legal obligations, primarily special handling for the removal and disposal of encapsulated asbestos from facilities and equipment. The fair value cannot be reasonably estimated because the settlement dates are undetermined.

Note 15: Discontinued Operations

Discontinued operations for the thirteen and twenty-six week periods ended June 25, 2006 include the company s North American composite panels operations which were sold in July 2006.

Discontinued operations for the thirteen and twenty-six week periods ended June 26, 2005, also include the company s B.C. Coastal operations which were sold in May 2005, and its French composite panels operations which were sold in December 2005.

The following table summarizes the U.S. dollar components of net earnings from discontinued operations for the thirteen and twenty-six week periods ended June 25, 2006, and June 26, 2005:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Net sales	$ 108	$ 239	$ 198	$ 503
Income from operations	21	27	24	36
Income tax expense	(7)	(8)	(8)	(12)
Net earnings from operations	14	19	16	24
Net gain on sale of B.C. Coastal operations		110		110
Earnings from discontinued operations, net of tax	$ 14	$ 129	$ 16	$ 134

No liabilities of the North American composite panels business were included in the sale. The following table summarizes the U.S. dollar carrying values of the held-for-sale assets of the North American composite panels business as of June 25, 2006 and December 25, 2005:

	June 25,	December 25,
Dollar amounts in millions	2006	2005
Inventory	$ 17	$ 18
Property and equipment	114	113
Construction in progress	3	5
Total assets of discontinued operations	$ 134	$ 136

B.C. Coastal sale

On May 30, 2005, the company sold its B.C. Coastal operations to Coastal Acquisition Ltd., a wholly-owned subsidiary of Brascan Corporation of Toronto, Canada for approximately $1.2 billion (Canadian) plus working capital. The sale included 635,000 acres (258,000 hectares) of private timberlands and the annual harvesting rights to 3.6 million cubic meters of timber subject to public timber leases. The sale also included five softwood sawmills, with a combined annual production of 690 million board feet, and two remanufacturing facilities. Prior to the sale, the company s B.C. Coastal operations were included in both the Timberlands and Wood Products segments.

The company recognized a gain on the sale of $110 million, including a tax benefit of $46 million, in the second quarter of 2005. The pretax gain of $64 million is included in contribution to earnings of the Corporate and Other segment for the thirteen and twenty-six week periods ended June 26, 2005. The company received net proceeds of approximately $1.1 billion (U.S.) from the sale, including working capital.

The income tax benefit recognized upon the sale of the B.C. Coastal operations included a deferred tax benefit of $185 million resulting from the rollout of temporary differences on the assets sold and current tax expense of $139 million on the taxable gain. Current taxes reflected the benefit of favorable capital gains treatment applicable to the sale of timberlands in Canada.

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Note 16: Business Segments

The company is principally engaged in the growing and harvesting of timber; the manufacture, distribution and sale of forest products; and real estate development and construction. The company s business segments are:

- Timberlands, which includes logs, chips, timber and other natural resources.
- Wood Products, which includes softwood lumber, plywood, veneer, composite panels, oriented strand board, hardwood lumber, engineered lumber, raw materials and building materials distribution.
- Cellulose Fiber and White Papers, which includes pulp, paper and liquid packaging board.
- Containerboard, Packaging and Recycling.
- Real Estate and Related Assets.
- Corporate and Other, which includes marine transportation (Westwood Shipping Lines, a wholly-owned subsidiary), distribution and converting facilities located outside North America, and general corporate support activities.

As discussed in Note 15: Discontinued Operations, the company sold its North American composites operations in July 2006. The segment data below includes the activities of the North American composites operations in the Wood Products segment for the thirteen and twenty-six week periods ended June 25, 2006 and June 26, 2005. In addition, the company sold its B.C. Coastal operations in the second quarter of 2005 and its French composites operations in the fourth quarter of 2005. The segment data below includes the activities of the B.C. Coastal operations in the Timberlands and Wood Products segments and includes the activities of the French composites operations in the Corporate and Other segment for the thirteen and twenty-six week periods ended June 26, 2005. The pretax gain of $64 million on the B.C. Coastal sale is included in the Corporate and Other segment for the thirteen and twenty-six week periods ended June 26, 2005.

During the second quarter of 2006, the company corrected the classification of rebates made on sales of certain wood products. In addition, the company corrected the classification of certain internal sales between Wood Products businesses that were previously reported as intersegment sales. As a result, prior period balances for third-party and intersegment sales of Wood Products segment have been reclassified for consistent presentation with the current period.

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An analysis and reconciliation of the company s business segment information to the respective information in the Consolidated Financial Statements is as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Sales to and revenues from unaffiliated customers:				
Timberlands	$ 269	$ 258	$ 532	$ 522
Wood Products	2,300	2,572	4,373	4,788
Cellulose Fiber and White Papers	1,126	1,077	2,233	2,155
Containerboard, Packaging and Recycling	1,237	1,223	2,364	2,386
Real Estate and Related Assets	746	648	1,436	1,303
Corporate and Other	117	151	233	300
	5,795	5,929	11,171	11,454
Less: sales of discontinued operations (Note 15)	(108)	(239)	(198)	(503)
	5,687	5,690	10,973	10,951
Intersegment sales:				
Timberlands	369	419	844	896
Wood Products	54	60	111	117
Cellulose Fiber and White Papers	11	11	18	23
Containerboard, Packaging and Recycling	13	18	32	32
Corporate and Other	5	4	11	9
	452	512	1,016	1,077
Total sales and revenues	6,139	6,202	11,989	12,028
Intersegment eliminations	(452)	(512)	(1,016)	(1,077)
	$ 5,687	$ 5,690	$ 10,973	$ 10,951
Contribution (charge) to earnings:				
Timberlands	$ 224	$ 210	$ 422	$ 410
Wood Products	131	204	248	335
Cellulose Fiber and White Papers	23	16	(740)	35
Containerboard, Packaging and Recycling	74	99	96	147
Real Estate and Related Assets	123	156	295	339
Corporate and Other	(40)	99	(142)	82
	535	784	179	1,348
Interest expense (Weyerhaeuser only)	(152)	(179)	(304)	(375)
Less: capitalized interest (Weyerhaeuser only)	20	2	36	2
Earnings (loss) from continuing and discontinued operations before income taxes	403	607	(89)	975
Income taxes (continuing and discontinued operations)	(89)	(187)	(177)	(316)
Net earnings (loss)	$ 314	$ 420	$ (266)	$ 659

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

WEYERHAEUSER COMPANY AND SUBSIDIARIES

Forward-Looking Statements

Some information included in this report contains statements concerning the company s future results and performance that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Some of these forward-looking statements can be identified by the use of forward-looking terminology such as expects, may, will, believes, should, approximately, anticipates, estimates, and plans, and the negative or other variations of those terms or comparable terminology or by discussions of strategy, plans or intentions. In particular, some of these forward-looking statements deal with expectations regarding the company s markets in the third quarter 2006; expected earnings and performance of the company s business segments during the third quarter 2006; demand and pricing for the company s products in the third quarter 2006; reduced harvest and sales activity from normal seasonal shutdowns; softening domestic log prices and lower sales of non-strategic properties in the third quarter 2006; lower prices for lumber, oriented strand board, and some engineered lumber products in the third quarter 2006, reduction in scheduled annual maintenance outages and improved operating performance in the Cellulose Fiber and White Papers segment; and related matters. The accuracy of such statements is subject to a number of risks, uncertainties and assumptions that may cause actual results to differ materially from those projected, including, but not limited to:

- The effect of general economic conditions, including the level of interest rates and housing starts;
- Market demand for the company s products, which may be tied to the relative strength of various U.S. business segments;
- Energy prices;
- Raw materials prices;
- Chemicals prices;
- Performance of the company s manufacturing operations including unexpected maintenance requirements;
- The successful execution of internal performance plans;
- The level of competition from domestic and foreign producers;
- The effect of forestry, land use, environmental and other governmental regulations, and changes in accounting regulations;
- The effect of weather;

The risk of loss from fires, floods, windstorms, hurricanes and other natural disasters;

Transportation costs;

Legal proceedings;

The effect of timing of retirements and changes in the market price of company stock on charges for stock-based compensation; and

Performance of pension investments and related derivatives.

The company is also a large exporter and is affected by changes in economic activity in Europe and Asia, particularly Japan, and by changes in currency exchange rates, particularly the relative value of the U.S. dollar to the Euro and the Canadian and New Zealand dollars, and restrictions on international trade or tariffs imposed on imports, including the countervailing and anti-dumping duties imposed on the company s softwood lumber shipments from Canada to the United States. These and other factors could cause or contribute to actual results differing materially from such forward-looking statements and, accordingly, no assurances can be given that any of the events anticipated by the forward-looking statements will occur, or if any of them occurs, what effect they will have on the company s results of operations, cash flows or financial condition. The company expressly declines any obligation to publicly revise any forward-looking statements that have been made to reflect the occurrence of events after the date of this report.

Results of Operations

The term company refers to Weyerhaeuser Company and all of its majority-owned domestic and foreign subsidiaries and variable interest entities of which Weyerhaeuser Company or its subsidiaries are determined to be the primary beneficiary. The term Weyerhaeuser refers to the forest products-based operations and excludes the Real Estate and Related Assets operations. The term price realizations refers to net selling prices, which include freight and are net of normal sales deductions. The term contribution to earnings refers to segment earnings before interest and taxes.

In the following discussion, unless otherwise noted, references to increases or decreases in income and expense items, price realizations, contribution (charge) to earnings, and shipment volumes are based on the thirteen and twenty-six week periods ended June 25, 2006, as compared to the thirteen and twenty-six week periods ended June 26, 2005. The thirteen week periods are also referred to as second quarter and the twenty-six week periods are also referred to as first half or year-to-date.

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Consolidated Results

A summary of consolidated results for the thirteen and twenty-six week periods ended June 25, 2006, and June 26, 2005, is as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	**June 26,**	**June 25,**	**June 26,**
Dollar amounts in millions, except per-share data	**2006**	**2005**	**2006**	**2005**
Net sales and revenues	$ 5,687	$ 5,690	$ 10,973	$ 10,951
Operating income	$ 475	$ 658	$ 63	$ 1,171
Net earnings (loss)	$ 314	$ 420	$ (266)	$ 659
Net earnings (loss) per share, basic	$ 1.27	$ 1.72	$ (1.08)	$ $2.70
Net earnings (loss) per share, diluted	$ 1.26	$ 1.71	$ (1.08)	$ $2.69

Consolidated net sales and revenues decreased $3 million and increased $22 million for the thirteen and twenty-six week periods ended June 25, 2006, respectively, as compared to the same periods in 2005. Sales of softwood lumber, plywood, oriented strand board (OSB), and containerboard declined in both periods, while sales of pulp and corrugated packaging increased. The decline in wood products sales related to continuing operations is primarily due to lower price realizations for softwood lumber and OSB in the thirteen and twenty-six week periods ended June 25, 2006. Increased pulp sales reflect improved price realizations and increased unit shipments, primarily due to improvements in the papergrade pulp markets. The increase in sales of corrugated packaging reflects an increase in U.S. demand for box shipments.

Net sales and revenues and operating income presented in the table above exclude the results of the company s British Columbia Coastal Group (B.C. Coastal) operations and French composites operations, which were sold in May and December 2005, respectively, and its North American composites operations which were sold in July 2006. Collectively, these operations are presented as discontinued operations in the accompanying Consolidated Financial Statements. See Note 15 of Notes to the Consolidated Financial Statements in Item 1. Financial Statements of this report.

Consolidated net earnings, which includes the results of discontinued operations, decreased $106 million and $925 million in the thirteen and twenty-six week periods ended June 25, 2006, respectively, as compared to the same periods in 2005, primarily due to the following items:

The company recognized charges of $746 million and $3 million in the first and second quarters of 2006, respectively, related to the impairment of goodwill associated with the Cellulose Fiber and White Papers segment.

The company recognized a $110 million gain, including a tax benefit of $46 million, on the sale of the B.C. Coastal operations in the second quarter of 2005. During the second quarter of 2005, the company also recognized an after-tax gain of $37 million that had been deferred on previous sales of timberlands.

The effect on increases in prices realized for pulp and fine paper largely offset the effect of declines in prices and volumes for wood products in the second quarter of 2006 as compared to the second quarter of 2005. The effect of declines in prices and volumes for wood products more than offset the effect of increases in prices realized on the sales of pulp and fine paper in the twenty-six week period ended June 25, 2006 compared to the 2005 period.

Net after-tax charges for interest expense decreased approximately $28 million and $65 million in the thirteen and twenty-six week periods, respectively, due primarily to $2.2 billion in debt reduction that has occurred during 2005 and year-to-date 2006.

These and other factors that affected the quarterly and year-to-date comparisons of operating income and net earnings (loss) are discussed in the following segment analyses.

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These and other factors that affected the quarterly and year-to-date comparisons of operating income and net earnings (loss) are discussed in the following segment analyses.

Timberlands

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	2006	2005	2006	2005
Net sales and revenues to unaffiliated customers	$ 269	$ 258	$ 532	$ 522
Intersegment sales	$ 369	$ 419	$ 844	$ 896
Contribution to earnings	$ 224	$ 210	$ 422	$ 410

Net sales and revenues to unaffiliated customers were higher for both the thirteen and twenty-six week periods ended June 25, 2006, as compared to the same periods of 2005. For both the second quarter and year-to-date periods, price realizations increased due to improved domestic and export log price realizations in the West, and increased domestic log price realizations in Canada. Those improvements more than offset lower log sales volume in the South and reduced Canadian activity in 2006 due to the May 2005 sale of the company s B.C. Coastal operations.

Intersegment sales declined in both the thirteen and twenty-six week periods ended June 25, 2006, as compared to the same periods of 2005, primarily due to the closure of the pulp and lumber mills in Saskatchewan in March and April of 2006. Intersegment sales volumes in the South were also lower in both the thirteen and twenty-six week periods ended June 25, 2006, due to slightly lower harvest levels of both fee and non-fee timber.

Contribution to earnings increased $14 million and $12 million for the thirteen and twenty-six weeks ended June 25, 2006, respectively, compared to the thirteen and twenty-six weeks ended June 26, 2005. Items that affected the quarterly and year-to-date comparison of Timberlands contribution to earnings include the following:

Improved price realizations and mix resulted in increased earnings of $12 million and $26 million for the thirteen and twenty-six week periods ended June 25, 2006, respectively, as compared to the same periods of 2005. Higher sales volumes, including both third-party and intersegment sales, contributed an additional $4 million and $8 million of earnings for the thirteen and twenty-six week periods, respectively.

Earnings from sales and exchanges of nonstrategic properties increased $18 million and $14 million for the thirteen and twenty-six weeks ended June 25, 2006, respectively, compared to the same periods in the prior year.

Net operating costs increased $13 million and $28 million for the thirteen and twenty-six week periods of 2006 as compared to the same periods of 2005. The second quarter increase was due mostly to higher fuel costs. The year-to-date increase was due to higher fuel costs and to increased salvage costs in the South related to hurricane Katrina.

The B.C. Coastal timberlands operations also contributed $6 million and $9 million of earnings in the thirteen and twenty-six weeks ended June 26, 2005, respectively, with no comparable earnings in 2006 due to the sale of the B.C. Coastal operations at the end of May 2005.

Timberlands third quarter earnings are expected to be lower than the second quarter due to seasonally reduced harvest and sales activity, softening domestic log prices and lower sales of non-strategic properties.

Third-party log sales volumes and fee harvest volumes for Timberlands for the thirteen and twenty-six week periods ended June 25, 2006, and June 26, 2005, are as follows:

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Volumes in thousands	2006	2005	2006	2005
Third-party log sales cunits (100 cubic feet)	808	863	1,743	1,727
Fee harvest cunits (100 cubic feet)	2,083	2,231	4,215	4,479

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Wood Products

	Thirteen weeks ended		Twenty-six weeks ended	
	June 25,	June 26,	June 25,	June 26,
Dollar amounts in millions	**2006**	**2005**	**2006**	**2005**
Net sales and revenues	$ 2,300	$ 2,572	$ 4,373	$ 4,788
Contribution to earnings	$ 131	$ 204	$ 248	$ 335

Demand for building products during the first half of 2006 was strong but slowed toward the end of the second quarter as compared to the same period in 2005. The seasonally adjusted annual rate of housing starts for the first quarter of 2006 was comparable to the first quarter of 2005. The seasonally adjusted annual rate of housing starts for the second quarter of 2006 averaged 1.9 million starts compared to 2.0 million in the second quarter of 2005. However, the June 2006 seasonally adjusted rate of starts declined 11 percent from the same month in 2005. Due to the apparent weakening in housing coupled with readily available supply and eroding prices, dealers and distributors appeared to maintain lean inventories throughout the first half of 2006, purchasing only enough to satisfy near-term needs. Structural panel price realizations declined steadily during the first half of 2006. Structural softwood lumber price realizations trended down throughout the period with the exception of a seasonal increase at the start of the second quarter. Average price realizations for engineered lumber were up approximately 3 percent on a year-to-date basis.

Net sales and revenues decreased $272 million, or 11 percent, for the thirteen-week period ended June 25, 2006, compared to the thirteen-week period ended June 26, 2005. The overall decrease is primarily the result of lower prices for structural panels and softwood lumber due to market factors mentioned above. The significant changes in second quarter net sales and revenues include the following:

- Sales of softwood lumber decreased $175 million. Price realizations decreased $33 per thousand board feet, or 8 percent. Shipment volume decreased 242 million board feet, or 10 percent. The primary factors for the decrease in lumber shipment volumes were the sale of the coastal British Columbia sawmills in May 2005, the closure of the Big River, Saskatchewan sawmill in April 2006; and the closure of the Aberdeen, Washington large log sawmill in the fourth quarter of 2005.

- Sales of structural panels, which include oriented strand board and plywood, decreased $82 million. Price realizations for oriented strand board decreased $39 per thousand square feet (3/8 basis), or 13 percent. Price realizations for plywood decreased $4 per thousand square feet (3/8 basis), or 1 percent. Shipments of oriented strand board increased 28 million square feet, or 3 percent, primarily due to the Sutton OSB mill press downtime in 2005. Shipments of plywood decreased 142 million square feet, or 24 percent, due to the closure of the Wright City, Oklahoma plywood mill in October 2005, the redirection of additional veneer production into engineered lumber products manufacturing, and the termination of distribution arrangements for certain outside suppliers.

- Sales of logs, chips and low cost raw materials decreased $33 million, primarily due to the sale of the B.C. Coastal operations in 2005.

- Sales of industrial products and other building products purchased for resale increased $14 million.

Net sales and revenues decreased $415 million, or 9 percent, in the first half of 2006, compared to the first half of 2005. The significant changes in year-to-date net sales and revenues included:

Sales of softwood lumber decreased $285 million. Price realizations decreased $30 per thousand board feet, or 7 percent. Shipment volume decreased 378 million board feet, or 9 percent, for the reasons discussed above.

Sales of structural panels decreased $131 million. Price realizations for oriented strand board decreased $34 per thousand square feet (3/8 basis), or 11 percent. Price realizations for plywood were flat. Shipments of oriented strand board increased 120 million square feet, or 6 percent, and shipments of plywood decreased 290 million square feet, or 26 percent, for reasons discussed above.

Sales of logs, chips and low cost raw materials decreased $65 million, primarily due to the sale of the B.C. Coastal operations in 2005.

Sales of engineered lumber products increased $47 million, due to increased price realizations of approximately 3 percent and a slight increase in shipment volumes. The increase in shipment volumes reflected strong demand for laminated veneer lumber and engineered i-joists, and construction-related downtime at one of the company s laminated strand lumber facilities in the spring of 2005.

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Sales of industrial products and other building products purchased for resale increased $16 million, primarily due to higher prices for composite products and hardwood lumber.

Segment contribution to earnings was $131 million in the thirteen weeks ended June 25, 2006, down from $204 million in the thirteen weeks ended June 26, 2005. The year-to-date contribution to earnings was $248 million for 2006, down from $335 million for 2005. The following factors affected the quarterly and year-to-date comparisons of segment contribution to earnings:

The net effect of sales price variances on earnings was a decrease of approximately $95 million in the second quarter of 2006 compared to the same period in 2005. Lower prices for lumber, plywood, and oriented strand board caused a decrease of $113 million, which was partially offset by increased prices for engineered lumber products, composite panels, and other products. On a year-to-date basis, the net effect on prices was a decrease to segment earnings of approximately $137 million in comparison to 2005.

The effect of shipment volumes on earnings was a decrease of approximately $21 million in the second quarter of 2006, compared to the second quarter of 2005, and a decrease in earnings of approximately $24 million in the first half of 2006 compared to 2005.

Partially offsetting the negative effects of sales prices, shipment volumes, and the unfavorable change in the Canadian to U.S. dollar exchange rate were reductions in the cost and volume of lumber and plywood purchased for resale, reductions in depreciation and pension expense, and the elimination of costs associated with the company s B.C. Coastal operations.

Weyerhaeuser expects substantially lower third quarter earnings from ongoing operations compared with second quarter due to declining prices and the absence of the North American composite earnings. The company closed the sale of its North American composite panels business in July 2006, and will recognize the resulting gain in the third quarter.

Third party sales and total production volumes for the major products in the Wood Products segment for the thirteen and twenty-six week periods ended June 25, 2006, and June 26, 2005, are as follows: