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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D. C. 20549

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**FORM 10-K**

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- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

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

Commission File Number 0-18050

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**PW EAGLE, INC.**

(Exact name of registrant as specified in its Charter)

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**Minnesota**  
(State of incorporation)

**41-1642846**  
(IRS Employer Identification No.)

**1550 Valley River Drive, Eugene, Oregon 97401**  
(Address of principal executive offices)

**(541) 343-0200**  
(Registrant's telephone number, including area code)

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**Securities registered pursuant to Section 12(b) of the Act: Common Stock, \$.01 par value**

**Securities registered pursuant to Section 12(g) of the Act: None**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
Yes  No

**Note:** Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of our common stock held by non-affiliates as of June 30, 2006 was approximately \$296,075,818 (based on the closing sale price of \$30.24 per share as reported on the NASDAQ Global Market).

The number of shares of the registrant's common stock, \$.01 par value, outstanding as of February 27, 2007 was 11,528,754.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the registrant's 2007 Annual Meeting of Shareholders are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this report.

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## PART I

### ITEM 1. BUSINESS

#### General

PW Eagle, Inc., a Minnesota corporation, (also referred to as we, us, our, the Company or PW Eagle) manufactures and distributes polyvinyl chloride (PVC) pipe and fittings used for potable water and sewage transmission, turf and agricultural irrigation, water wells, fiber optic lines, electronic and telephone lines, and commercial and industrial plumbing. We distribute our products throughout the entire United States, with a minimal amount of shipments to selected foreign countries. Our wholly-owned subsidiary, USPoly Company, LLC, (USPoly) manufactures and distributes polyethylene (PE) pipe products and accessories. The Company was organized as a corporation under the laws of the state of Minnesota in 1989.

Our executive offices and operating headquarters are located in Eugene, Oregon. We have production facilities in Cameron Park, Visalia and Perris, California; Columbia, Missouri; Hastings, Nebraska; Tulsa, Oklahoma; Eugene, Oregon; Conroe, Texas; Buckhannon, West Virginia; Tacoma and Sunnyside, Washington; and West Jordan, Utah.

Our web address is [www.pweagleinc.com](http://www.pweagleinc.com). USPoly's web address is [www.uspolycompany.com](http://www.uspolycompany.com). Investors can access our news releases and the periodic reports we file with the Securities and Exchange Commission free of charge on our web site.

#### Recently Announced Transaction

On January 15, 2007, we announced that we had entered into a definitive merger agreement under which J-M Manufacturing Company, Inc. ("JMM") will acquire all of the outstanding common shares of PW Eagle for \$33.50 per share in cash. The transaction is expected to be completed during the second quarter of 2007, subject to customary closing conditions, including the receipt of regulatory approvals and approval by the shareholders of PW Eagle. JMM, headquartered in Livingston, New Jersey, operates a total of 14 plastic pipe manufacturing facilities and serves customers throughout North America.

#### Our PVC Pipe Business

We manufacture and distribute PVC pipe and fittings under the name PW Eagle. Our pressure and non-pressure PVC products consist of ½-inch to 36-inch PVC pipe for applications in the building, municipal water distribution, municipal sewage collection, turf and agriculture irrigation, fiber optic, power distribution and telecommunications industries. We look for new markets and, when appropriate, produce specialized products for our customers. Below are descriptions of our primary PVC pipe products and their applications.

A major use of PVC pipe is transporting water under pressure. We manufacture and distribute many PVC pressure pipe products for the transporting of drinking and irrigation water, including the following:

*American Water Works Association (AWWA) Water Main Pipe.* We offer this product in diameters of 4" to 24". During the manufacturing process, each piece of this AWWA pipe is filled with water and proof tested. This pipe is also used in fire protection and carries the listing of Factory Mutual and Underwriters Laboratories (UL).

*Ultra-Blue Water Main Pipe.* *Ultra-Blue* is a molecular oriented PVC (MOPVC) pipe manufactured using proprietary processes that change the molecular orientation of the pipe, yielding greater strength, lighter weight and greater flow capacity than conventional PVC pipe. We produce *Ultra-Blue* in 6” through 16” diameters.

*American Society for Testing and Materials (ASTM) PVC Pressure Pipe.* Manufactured in diameters of ½” to 24” in a series of pressure ratings from 63 pounds to 315 pounds, this product delivers the water to grow crops and beautify parks, golf courses and homes.

*ASTM PVC Well Casing.* We offer a lightweight PVC pipe to be used as casing in water wells. Like the majority of our pressure pipes, well casing is in compliance with *ANSI/NSF Standard 61 – Health Effects*. As a companion to our well casing pipe, we also offer a threaded drop pipe for hanging submersible pumps. These heavy-duty pipes are made from thick-wall PVC and weigh approximately one-seventh of an equivalent metal pipe.

For many of the same reasons that plastic pipes are the materials of choice for pressure piping systems, PVC pipe is used in non-pressure applications. We service homes and industry through the production of non-pressure pipes to carry sewage, electrical power, fiber optics and telecommunications.

*ASTM Gravity PVC Sewer Pipe.* Sewer pipe is used to transport wastewater from residential and commercial buildings to a treatment plant. Manufactured in diameters from 4” through 24”, our products are used throughout the collection system of sewage treatment plants.

*Ultra-Rib and Ultra-Corr Pipe.* These structured wall pipes are offered in diameters from 8” to 36” for applications in sanitary sewers and storm drains. The proprietary design of these products provides significant strength and weight advantages in comparison to both conventional PVC pipes and competitive materials.

*ASTM Drain, Waste and Vent (DWV) Pipe.* This PVC DWV pipe is used inside the home to drain wastewater and vent the plumbing system. We offer this product in sizes up to 6” in diameter from either a solid wall construction, or a construction that layers solid walls around a cellular core. This ASTM coex cellular core pipe is very tough while having a lighter weight.

*Underwriters Laboratories (UL) Electrical Conduit.* We manufacture a complete line of PVC heavy wall electrical conduit in diameters of ½” through 6” and fabricated fittings. The entire product line carries the UL mark and conforms to National Electrical Manufacturers Association Standards. This pipe carries electrical wiring below and above ground.

*ASTM Utility Duct.* Our PVC utility duct is used to carry power lines underground and house fiber optic and telephone communication lines.

## **Our PE Pipe Business**

In February 2003, we created a separate subsidiary, PWPoly, and in September 2003 we transferred certain assets and liabilities of our PE pipe business to PWPoly. In September 2004, we acquired substantially all of the assets of Uponor Aldyl Company Inc.’s (UAC) PE pipe business. These combined businesses are now operated as a separate wholly-owned subsidiary, USPoly Company, LLC.

USPoly focuses on extruding PE pipe in sizes up to 20 inches in diameter. USPoly’s pressure and non-pressure PE pipe products consist of ½ inch to 20 inch PE pipe and tubing for applications in the natural gas distribution, municipal water distribution, irrigation, fiber optic, power distribution and telecommunications industries. Below are descriptions of our primary PE pipe products and their applications.

*Natural Gas Distribution Pipe.* We sell PE pipe for natural gas distribution in diameters from ½ inch to 12 inches, in either straight sticks or coils depending on customer requirements and diameter. We use Plastics Pipe Institute (PPI)-approved PE 2406, PE 3408 and PE 100 resins to manufacture gas distribution pipe.

*Oil and Gas Gathering Pipe.* We offer a full range of pipes through 20 inches for this application. Oil and gas gathering pipes are made with PE 3408 resin in coils or sticks.

*Irrigation and Agricultural Pipe.* These pipes are usually smaller in diameter and are made from PE 2406, PE 3408 or linear low-density PE resin, as required by customers.

*Water Distribution Pipe.* Water distribution pipes are often produced and sold in larger diameters, up to 20 inches. We use PE 3408 resin for this application and manufacture these products to meet NSF and AWWA requirements.

*ASTM PE Pipes for Special Applications.* PE's unique properties produce valuable products for applications in fiber optic communications, mining, chemical transport and closed-loop ground coupled heat pump systems. We offer these products in various diameters and use different resins depending on customer requirements.

*Fittings.* We offer a full line of fittings to complete our PE piping systems. Our product line includes butt and socket PE fittings, electrofusion PE fittings and our patented MetFit™ fittings system. MetFit™ is a steel-insert reinforced, nylon body plastic fitting that can make high quality connections under any conditions.

### **Marketing and Customers**

We market our products through a combination of independent sales representatives, company salespersons and inside sales/customer service representatives. All sales representatives are primarily assigned to product lines and geographic territories. Our primary geographic market is the United States with a minimal amount of shipments to selected foreign countries.

Our marketing strategy focuses on providing high quality products and responsive customer service. We believe our products enjoy wide acceptance and recognition.

Generally, our products are warranted for one year. We maintain product liability insurance to cover such warranty claims and, to date, warranty reserves have been sufficient to cover warranty claims.

We have a broad and diverse group of customers consisting primarily of wholesalers and distributors. Sales to HD Supply, a customer of both the PVC and PE segments and not otherwise affiliated with the Company, totaled approximately 12% of consolidated sales in 2006. No customer accounted for more than 10% of our net sales in 2005 or 2004.

### **Competition in the PVC and PE Pipe Industry**

The plastic pipe industry is highly fragmented and competitive, due to the large number of producers and the commodity nature of the industry. Because of shipping costs, competition is usually regional, instead of national, in scope and the principal methods of competition are a combination of price, service, warranty and product performance. We compete not only against other PVC and PE plastic pipe manufacturers, but also against ductile iron, steel, concrete and clay pipe producers. Although we believe we have lessened the commodity nature of our business through our brand name and proprietary pipe products, pricing pressure has affected our operating margins and will continue to do so in the future.

### **Manufacturing and Supply Sources**

Our executive offices and operating headquarters are located in Eugene, Oregon. We have PVC pipe manufacturing facilities in Cameron Park, Visalia and Perris, California; Columbia, Missouri; Hastings, Nebraska; Eugene, Oregon; Conroe, Texas; West Jordan, Utah; Buckhannon, West Virginia; and Tacoma and Sunnyside, Washington. PVC electrical fittings are fabricated in Tacoma, Washington; and Cameron Park and Perris, California. PE pipe is manufactured in Hastings, Nebraska and Tulsa, Oklahoma. A PE fittings manufacturing facility is located in Tulsa, Oklahoma.

The eleven PVC pipe manufacturing facilities have blending centers where PVC resin is mixed with additives to create an appropriate compound for each extrusion application. In the PE pipe manufacturing facilities, natural PE resin is mixed with a pre-compound blend containing color and additives.

PVC and PE pipes are manufactured using the extrusion process. Compound is delivered to the extruder, heated to a plastic state and conveyed through dies and sizing equipment to form pipes of the appropriate diameter and wall thickness. The continuously formed product is cooled, cut to length, and if appropriate to the product, has a bell formed on one end. Following quality inspection, the packaged product is stored, generally in outside storage yards, although certain products are warehoused. Inventory is shipped from storage to customers by common carrier and by company owned trucks.

At each phase of the manufacturing process, we pay attention to quality and production of a consistent product. Our PVC and PE pipe products are produced in compliance with consensus standards, such as American Society for Testing Materials, American Water Works Association and Underwriter's Laboratory. We have a quality assurance program, which has its own testing lab for both resin and finished goods.

We acquire our PVC resin in bulk, mainly by rail car, and are substantially dependent on one supplier. We acquire our PE resin in bulk, mainly by rail car, and are substantially dependent on two suppliers. During the years ended December 31, 2006, 2005 and 2004, purchases of PVC and PE resin from three vendors totaled 90%, 90% and 87% of total material purchases, respectively. We strive to maintain strong relationships with our key raw material vendors to ensure the quality

and availability of raw material. We believe our relationships with our key raw material vendors are good. However, the loss of a key supplier could have a significant impact on our business.

### **Business Seasonality**

Due to general weather constraints in the geographic markets in which our customers operate, the demand for our products tends to be seasonal. As a result, we experience fluctuations in sales, accounts receivable and inventory levels during the year. Generally our sales are weaker during the winter months, when residential and commercial construction activity is slower, and improve during the second and third quarters, when such construction activity is stronger.

### **Backlog**

Our goal is to keep delivery lead times to a minimum in order to meet customer requirements, thus minimizing backlog. Our backlog on February 27, 2007, was approximately \$49.9 million compared to \$42.0 million on March 1, 2006.

### **Employees**

The table below summarizes the approximate number of our employees in January 2007:

	<b>PVC</b>	<b>PE</b>	<b>Total</b>
Administration	135	27	162
Sales and marketing	56	11	67
Manufacturing	690	173	863
Total	881	211	1,092

Except for our production and maintenance employees at the Buckhannon, West Virginia facility, none of our employees are represented by a labor union, and we have never experienced any work stoppages.

## **ITEM 1A. RISK FACTORS**

The risks described below are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

### **The pipe industry and our business are heavily dependent on the price and trend of resin, our main raw material.**

Our gross margin percentage is sensitive to raw material resin prices and the demand for PVC and PE pipe. Historically, when resin prices are rising or stable, our margins and sales volume have been higher. Conversely, when resin prices are falling, our sales volumes and margins have been lower. In response to hurricane-related supply disruptions and increasing energy and raw material costs, PVC resin producers implemented increases in September and October 2005. Starting in December 2005, and continuing through the first few months of 2006, PVC resin prices decreased, stabilized during the second quarter, and increased in the third quarter. PVC resin prices decreased significantly in the fourth quarter of 2006 in response to lower demand and decreasing raw material costs.

Our gross margins decrease when the supply of resin and pipe is greater than demand. Conversely, our gross margins improve when resin and pipe are in short supply. In April 2001, a major producer of PVC resin filed for bankruptcy and, during the first quarter of 2002 ceased operations at two manufacturing facilities. This resulted in a reduction of approximately 1.0 billion pounds of production capacity, or 5% of the North American industry capacity. Although two PVC producers have subsequently purchased these two facilities, only one of them has re-started a portion of its capacity. In December 2004, a major PVC producer announced plans to build a PVC plant with annual capacity of 1.3 billion pounds together with integrated production of chlorine and vinyl chloride monomer (VCM), with completion expected in late 2007 for the first phase and 2008 for the second phase. During 2005, two other PVC producers announced smaller expansions of existing facilities which are expected to be completed in 2007. If these capacity increases result in industry capacity exceeding demand when they begin production, it could result in decreasing prices for PVC resin and negatively impact our gross margins.

### **The demand for our products is directly affected by the growth and contraction of the Gross Domestic Product and economic conditions.**

Due to the commodity nature of resin, pipe and the dynamic supply and demand factors worldwide, the markets for both resin and pipe have historically been very cyclical with significant fluctuations in prices and gross margins. Generally, after a period of rising or stable resin prices, capacity has increased to exceed demand with a resulting decrease in prices and gross margins. Over the last ten years, there have been consolidations in both markets, particularly with respect to PVC resin manufacturers. During the same period, the capacity of PVC resin producers has increased from just over 9 billion pounds to over 18 billion pounds today. In the last ten years published PVC resin prices have fluctuated between approximately \$0.24 and \$0.67 per pound. Since peaking in October 2005, published PVC resin prices have decreased approximately \$0.13 per pound.

We believe the main drivers of industry performance are U.S. Gross Domestic Product (GDP) growth and supply and demand of PVC resin. Historically, our profitability has improved during periods of strong GDP growth and decreased during periods of slower growth or recession. The hurricane-related supply and demand imbalances experienced during the fourth quarter of 2005 resulted in very strong margins which continued through the first three quarters of 2006. By the fourth quarter of 2006, there was more than sufficient resin supply compared to demand which resulted in a significant reduction in margins compared to the first three quarters of 2006. Additionally, because our products are used in both new residential and commercial construction and replacement and upgrade projects, a significant or prolonged decrease in the level of construction activity in the U.S. could lead to decreased demand for PVC and PE pipe, and result in lower prices and margins.

While we expect the demand for PVC and PE pipe to continue to increase over the long term, we also expect that the industry will continue to be subject to cyclical fluctuations and times when supply will exceed demand, driving prices and margins down. These conditions could result from a general economic slowdown either domestically or elsewhere in the world or capacity increases in either the resin or pipe markets. General economic conditions both in the United States and abroad will continue to have a significant impact on our prices and gross margins.

**We are substantially dependent on one supplier of PVC resin, our primary raw material. Our business and operating results could be seriously harmed if this supplier were unable to timely meet our requirements on a cost effective basis. Additionally, certain terms of our agreement with this supplier limit our business and operating flexibility.**

Our key raw materials, PE and PVC resin, are procured primarily from three suppliers. The cost, quality and availability of these raw materials, chief among them PVC resin, are essential to the successful production and sale of our products. There are a limited number of suppliers of PVC resin. Alternative sources are not always available or may not be available on terms acceptable to us. For example, there are currently only five suppliers of PVC resin in North America who are capable of providing us the material in an amount that would meet our requirements on terms acceptable to us. We have a long-term agreement in place with one PVC resin supplier and thus are substantially dependent upon our relationship with that supplier, which we believe to be good. However, if our supplier experienced a natural disaster, a serious incident at a major production facility that limited production of PVC resin, or experienced any other event that resulted in a significant and extended limitation on its ability to provide us with PVC resin or was unwilling to meet our demand for PVC resin on terms acceptable to us and if we are unable to obtain an alternative source or if the price for an alternative source is prohibitive, our ability to maintain timely and cost-effective production of our products will be seriously harmed.

In September and October of 2005, all five PVC resin suppliers in North America declared *force majeure* due to the effects of Hurricanes Katrina and Rita, and due to an accident at one resin manufacturing facility. Despite this situation, we were able to secure sufficient amounts of raw material to maintain our operations at reasonable levels, primarily because of our agreement with our PVC supplier. Since early in first quarter of 2006, resin suppliers were able to increase production to levels such that there are no longer supply limitations. However, if similar disruptions in our raw material supply occur in the future, we may be unable to effectively utilize our manufacturing capacity.

The terms of our long-term agreement with our PVC supplier provide, among other things, for the extension of the agreement at the supplier's option through 2013, certain termination rights exercisable by the supplier without corresponding rights for us, a right of first negotiation with the supplier on the sale of the assets of one or more of our facilities that utilize PVC resin, and the supplier's option to require a buyer of all or a substantial portion of our assets to assume the agreement. These provisions may have the effect of limiting our ability to replace the supplier, procure PVC resin under more favorable terms or divest of our assets.

**A significant portion of our business and the demand for our products is seasonal in nature and any adverse weather conditions that result in a slowdown in the construction industry may adversely affect demand for our products.**

Our products are used in new residential and commercial construction. Because of this, the demand for these products tends to be seasonal to correspond with increased construction activity in the late spring, summer, and early fall. Any significant or prolonged adverse weather conditions that negatively affect the construction industry or slow the growth of new construction activity may negatively affect our operating results.

**Our operating results are dependent on the price of resin and any competitive pressure in the resin industry that increases supply or decreases the price of resin may negatively affect our profitability.**

The primary raw material used in most of our products is PVC resin. Generally, in periods of strong demand and limited supply of PVC resin, prices of resin tend to increase. Conversely, PVC resin prices tend to decrease when demand is weak and there is excess supply. Historically, in response to increasing resin prices, we have been able to increase the price of our products at a greater rate, resulting in better margins. During periods of decreasing resin prices, our selling prices have tended to decrease faster than our raw material costs, resulting in lower margins. In the event of a significant increase in PVC resin capacity or a significant decrease in the demand for PVC resin, resulting in a period where there is an excess supply of PVC resin, our margins and profitability could be negatively impacted.

**The proposed merger with JMM is subject to conditions to closing, including the receipt of the required approval by our shareholders and regulatory approvals, which could result in the merger being delayed or not consummated, and could negatively impact our business, stock price, financial condition and operations.**

The proposed merger with JMM is subject to conditions to closing as set forth in the merger agreement, including obtaining the required approval from our shareholders and obtaining all proper regulatory approvals. If any of the conditions to the merger is not satisfied or, where permissible, not waived, the merger will not be consummated. The delay or failure to consummate the merger could negatively impact our business, stock price, and financial condition. Our failure to consummate the merger may negatively impact our future business, growth, revenue, and results of operations and our ability to attract any future potential acquirer.

We are required to file a notification form with the United States Department of Justice and the Federal Trade Commission to determine whether the merger with JMM complies with applicable antitrust laws. We may not complete the merger until the expiration of a waiting period that follows the filing of the notification form. There is a risk that this regulatory approval may not be obtained or is obtained subject to conditions that are not anticipated. If such regulatory approval is not obtained or delayed, or if such regulatory approval is subject to conditions that we do not currently anticipate, the merger may not happen or at best it will be delayed. Such delay or the failure to consummate the merger may have an adverse effect on our current, and if the merger is not consummated, our future, business, stock price, financial condition and results of operations.

**The uncertain effects of the pendency of the proposed merger with JMM may negatively impact our business relationships, operating results and business generally, including our ability to retain key employees, suppliers and customers during the pendency of the merger.**

Because the merger with JMM is subject to various closing conditions, uncertainty exists regarding the completion of such merger. This uncertainty may cause employees, suppliers and customers to delay or defer decisions concerning us, or elect to switch to other companies or suppliers prior to the merger, which could negatively affect our business and our results of operations.

Some customers may seek alternative sources for products and services pending the completion of the merger due to, among other reasons, a desire not to do business with the combined company or perceived concerns that the combined company may not continue to maintain the same quality, or support and develop such products and services in the same manner, as we do. In addition, if the merger does not occur for any reason, our relationships with our current customers and suppliers may be adversely affected.

Some of our employees may choose not to continue with us during the pendency of the merger due to a perception of uncertainty about the merger, their job security and the surviving company.

**While the terms of the merger agreement allow us to consider unsolicited alternative proposals under certain circumstances, they prohibit solicitation of other proposals by us.**

Certain provisions included in the merger agreement make it difficult for us to sell our business to a party other than JMM. These provisions include the general prohibition on us from soliciting any acquisition proposal or offer for a competing transaction, and a requirement that we pay a termination fee equal to 3% of the aggregate merger consideration and the

reasonable and documented out of pocket expenses of JMM in connection with the merger, not exceeding \$2,500,000, if the merger agreement is terminated in specified circumstances. These provisions might discourage a third party with an interest in acquiring us from considering or proposing an acquisition, including a proposal that might be more advantageous to our shareholders when compared to the terms and conditions of the pending merger with JMM. Furthermore, the termination fee may result in a potential competing acquirer proposing to pay a lower per share price to acquire us than it might otherwise have proposed to pay our shareholders.

**There is the potential that because of certain covenants we agreed to in the merger agreement that restrict the conduct of our business prior to the completion of the merger, there could be an adverse effect on our business, properties and operations.**

Pursuant to the merger agreement, prior to the consummation of the merger with JMM, we have made certain covenants that restrict our business. These prohibitions include, but are not limited to, (i) merging or consolidating with any company other than JMM, (ii) acquiring any company, (iii) issuing, selling, pledging, disposing of, transferring or encumbering any of our shares of common stock, (iv) paying any dividends, (v) creating or incurring any lien on our assets, (vi) making any loan, advancing any money or making a capital contribution in excess of \$50,000, (vii) incurring any indebtedness for borrowed money other than in the ordinary course of business not to exceed \$500,000, (viii) except as disclosed in the merger agreement, making or authorizing any capital expenditure and (ix) entering into any material contract.

These covenants could have an adverse effect on our business pending the merger, by limiting our ability to take advantage of a financing, merger and acquisition or other corporate opportunity.

**The financing contemplated by JMM for the consummation of the merger might not be obtained.**

JMM currently has commitments from lenders to finance the merger, but these commitments may change prior to the consummation of the merger. If any of these commitments fall through, JMM will look for other acceptable alternative commitments. This may cause a delay in the consummation of the merger, which may have a negative effect on our business, stock price, financial condition and results of operations. Under the terms of the merger agreement, JMM is obligated to proceed with the merger even if it fails to obtain the necessary financing, but this may be difficult for it to do. If JMM is unable to find acceptable replacement financing, there is a chance that the merger will not be consummated. The failure to consummate the merger with JMM may have a further negative impact on our future business, stock price, customer and employee perception, financial condition and results of operations and our ability to attract any future potential acquirer.

**There is a chance that the occurrence of certain events, changes or other circumstances may arise that could give rise to the termination of the merger agreement, including circumstances that may require us to pay a termination fee and related expenses to JMM.**

In the merger agreement we agreed to pay JMM a termination fee equal to 3% of the aggregate merger consideration and the reasonable and documented out of pocket expenses of JMM in connection with the merger, not exceeding \$2,500,000, if our board of directors terminates the merger agreement and authorizes a competing acquisition by an entity other than JMM and in the event of certain other specified events that result in termination of the merger agreement. The termination fee could discourage other companies from trying to acquire us even if another acquisition would offer greater immediate value to our shareholders.

**The proposed merger with JMM may not be completed in a timely manner or at all, which may materially adversely affect our business, future prospects and the price of our common stock.**

If the merger with JMM is not completed, the trading price of our common stock may decline to the extent that the current market price reflects a market assumption that the merger with JMM will be completed. In addition, our business and operations may be harmed to the extent that our customers, suppliers and others believe that we cannot effectively compete in the marketplace without the merger, or there is customer, supplier or employee uncertainty surrounding the future direction of the product and service offerings and our strategy on a stand-alone basis.

In addition, any future potential acquirer would be cautious in exploring any future transaction with us.

**We have incurred, and will continue to incur, significant costs in connection with the merger with JMM.**

We have incurred, and will continue to incur, substantial costs in connection with the merger. These costs are primarily associated with the fees of attorneys, accountants and financial advisors. If the merger is not completed, we will have incurred these costs but will have received little or no benefit.

**If litigation is initiated with respect to the merger with JMM, the completion of the merger may be jeopardized and our business, financial condition and results of operations may be adversely impacted.**

At any time, the antitrust division of the United States Department of Justice, the Federal Trade Commission, or another federal or state governmental authority could challenge or seek to block the merger with JMM under antitrust laws, as it deems necessary or desirable in the public interest. The antitrust law section of the office of the California attorney general has requested that we voluntarily provide that office with information regarding the proposed merger, which we are doing. We do not know what, if any, antitrust issues or concerns may be raised by this state office or what impact this may have on our ability to consummate the merger in a timely fashion. Moreover, in some jurisdictions, a competitor, customer, or other third party could initiate a private action under antitrust laws challenging or seeking to enjoin the merger with JMM, before or after it is completed. We cannot be sure that a challenge to the merger with JMM will not be made or that, if a challenge is made, that we will prevail.

Further, if litigation is initiated relating to the merger by our shareholders, JMM's shareholders, the parties to the merger, or other third parties, this may affect the completion of the merger. Such potential litigation may be costly and time consuming. If the merger is delayed or is not consummated, our business, stock price, financial condition and results of operations may be negatively impacted. Further, the perception arising from any such litigation may negatively impact our future business, stock price, financial condition and results of operations, if the merger is not consummated.

**During the pendency of the merger with JMM, our management's attention may be diverted from our ongoing business operations, which may result in our business and results of operation being adversely affected.**

During the pendency of the merger, our management will be required to devote a portion of its time to help ensure that each condition necessary for the consummation of the merger with JMM is met. Our management will also be asked by JMM to help ensure that the transition of our business to JMM is done properly. The attention given to the merger may result in our management not being able to devote sufficient time to other areas of the business, especially if disputes arise between the parties or if litigation is commenced in connection with the merger.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

#### **ITEM 2. PROPERTIES**

Our executive offices and operating headquarters are located in leased office space in Eugene, Oregon. Our PVC pipe manufacturing and warehouse facilities are located in Cameron Park, Visalia and Perris, California; Columbia, Missouri; Hastings, Nebraska; Eugene, Oregon; Conroe, Texas; Buckhannon, West Virginia; West Jordan, Utah; and Tacoma and Sunnyside, Washington. We both own and lease portions of our facilities in Hastings, Nebraska and lease our manufacturing facilities in Eugene, Oregon and Conroe, Texas. We lease our operating headquarters in Eugene, Oregon and manufacturing plants in Perris and Visalia, California, West Jordan, Utah and Tacoma and Sunnyside, Washington pursuant to long-term lease agreements (see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Notes to the Consolidated Financial Statements under Item 8.).

USPoly has manufacturing facilities in Hastings, Nebraska, and Tulsa, Oklahoma. The Tulsa and Hastings facilities are leased pursuant to long-term lease agreements.

In August 2006, we sold USPoly's former production location in Shawnee, Oklahoma for \$0.9 million.

We believe that the production capacity of our facilities is sufficient to meet our current and future needs. The manufacturing facilities, as currently equipped, were operating at approximately 93% of capacity in the first quarter of 2007.

#### **ITEM 3. LEGAL PROCEEDINGS**

We are from time to time a party to various claims and litigation matters incidental to our normal course of business. We are not a party to any material litigation and are not aware of any threatened litigation that would have a material adverse effect on our business.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal year 2006.

#### PART II

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is currently traded on the NASDAQ Global Market under the symbol "PWEI." The following table sets forth the high and low closing prices of a share of common stock for each fiscal quarter in 2006 and 2005:

	<u>High</u>	<u>Low</u>
Year ended December 31, 2006:		
First Quarter	\$ 28.20	\$18.52
Second Quarter	31.95	24.55
Third Quarter	37.00	24.05
Fourth Quarter	38.16	29.05
Year ended December 31, 2005:		
First Quarter	\$ 4.39	\$ 2.95
Second Quarter	7.25	3.28
Third Quarter	8.53	5.15
Fourth Quarter	25.00	7.68

On February 27, 2007, there were 11,528,754 shares of common stock outstanding held by 1,034 shareholders of record (not including shares held in street name).

In December 2005, the Board of Directors declared the Company's first quarterly dividend of \$0.075 per share, payable in January 2006. Subsequent quarterly dividends of \$0.075 per share were paid in April and October of 2006 and January of 2007. We have agreed in the merger agreement with JMM not to declare or pay any additional dividends from the date of the merger agreement through the closing of the merger.

During the past three years, the Registrant sold the securities listed below pursuant to exemptions from registration under the Securities Act, which were not otherwise reported on a quarterly report on Form 10-Q or a current report on Form 8-K.

On December 22, 2005, PW Eagle entered into a Common Stock and Warrant Purchase Agreement with a single investor for the private placement of 18,667 shares of the Company's common stock at a price of \$18.75 and warrants to purchase an additional 4,667 shares of common stock with an exercise price of \$27.00 per share. The aggregate offering price was \$350,000. The warrants contain a net exercise provision. Such securities were offered and issued in reliance on the exemption from registration provided by Rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933, as a transaction not involving a public offering of securities.

The following table provides information about purchases made by us of our Common Stock in the fourth quarter of fiscal 2006.

				(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the
	(a) Total Number of Shares (or Units)	(b) Average Price Paid	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced	

Period	Purchased (1)	per Share (or Unit)	Plans or Programs	Plans or Programs (1)
October 1 – October 31, 2006	115,198	\$ 31.2741	493,753	\$24.8 million
November 1 – November 30, 2006	19,196	\$ 33.8184	512,949	\$24.2 million
December 1 – December 30, 2006	16,916	\$ 33.9376	529,865	\$23.6 million
Total – Q4, 2006	151,310			

(1) On June 16, 2006, our Board of Directors approved a share repurchase program, whereby the Company was authorized to repurchase up to \$40 million of the Company's common stock outstanding through June 30, 2008. Repurchases may be made in the open market and in privately negotiated transactions utilizing various hedge mechanisms, including, among other things, the sale to third parties of put options for the Company's common shares, or otherwise. The repurchase program was announced on June 16, 2006. No share repurchase plan or program expired, or was terminated, during the period covered by this report.

## ITEM 6. SELECTED FINANCIAL DATA

	Years ended December 31				
	(in thousand, except for per share amounts)				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>SUMMARY OF OPERATIONS</b>					
Net sales	\$ 714,112	\$ 694,244	\$ 474,954	\$ 331,787	\$ 251,275
Gross profit	174,642	159,389	70,136	36,749	45,479
Operating expenses	74,703	70,608	58,858	45,837	33,534
Operating income (loss)	99,939	88,781	11,278	(9,088)	11,945
Gain on sale of investee and non-operating income	897	18,363	--	--	--
Interest expense	(3,800)	(27,051)	(20,668)	(11,828)	(11,001)
Income (loss) from continuing operations before income taxes, minority interest and equity in undistributed earnings of unconsolidated affiliate	97,036	80,093	(9,390)	(20,916)	944
Income (loss) from continuing operations (net of tax)	60,695	46,950	(5,540)	(12,912)	571
Income from discontinued operations (net of tax)	--	--	--	194	--
Net income (loss)	60,695	46,950	(5,540)	(12,718)	571
<b>PER SHARE DATA</b>					
Income (loss) from continuing operations per share:					
Basic	\$ 5.09	\$ 5.28	\$ (0.78)	\$ (1.89)	\$ 0.09
Diluted	\$ 5.02	\$ 4.65	\$ (0.78)	\$ (1.89)	\$ 0.06
Income from discontinued operations per share:					
Basic	\$ --	\$ --	\$ --	\$ 0.03	\$ --
Diluted	\$ --	\$ --	\$ --	\$ 0.03	\$ --
Net income (loss) per share:					
Basic	\$ 5.09	\$ 5.28	\$ (0.78)	\$ (1.86)	\$ 0.09
Diluted	\$ 5.02	\$ 4.65	\$ (0.78)	\$ (1.86)	\$ 0.06
Cash dividends declared per common share	\$ 0.30	\$ 0.075	\$ --	\$ --	\$ --
Weighted average number of common shares outstanding:					
Basic	11,930	8,888	7,096	6,852	6,717

Diluted	12,096	10,094	7,096	6,852	9,376
FINANCIAL POSITION					
Working capital (deficiency)	\$ 99,505	\$ 38,267	\$ (17,480)	\$ (3,610)	\$ 13,620
Total assets	242,574	234,456	216,726	165,178	133,402
Long-term and subordinated debt and financing lease obligation, net of current portion	19,302	19,525	54,713	59,827	58,725
Stock warrants (included under liabilities)	--	--	2,627	--	--
Stockholders' equity	145,397	86,039	12,613	15,235	25,919

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing under Item 8. Some of the information contained in this discussion and analysis or set forth elsewhere in this annual report, including information with respect to our plans and strategy for our business and related financing, includes forward-looking statements that involve risks and uncertainties. You should review the "Risk Factors" under Item 1A, and the "Future Outlook and Risks to Our Business" comments below, for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.*

### **Executive Summary**

Throughout 2006, we have continued the success from 2005. Our operating performance has continued to improve, with our net income for 2006 amounting to \$60.7 million compared to \$47.0 million in 2005. Our resulting net cash flow from operations in 2006 amounted to \$50.5 million, after paying \$53.3 million in income taxes for 2005 and 2006. The positive cash from operations allowed us to pay down our revolving line of credit by \$7.2 million, purchase \$16.4 million of our common stock in our share repurchase program, pay \$3.6 million in dividends, and still increase our cash position to \$38.1 million at the end of 2006 compared to \$5.7 million at the end of 2005. As a result, our financial position at December 31, 2006 is very strong.

We believe the main drivers of industry performance are U.S. gross domestic product (GDP) growth and supply and demand of PVC and PE resin. Historically, our profitability has improved during periods of strong GDP growth and decreased during periods of slower growth or recession. GDP growth has improved somewhat in 2006, with the GDP growth reported at 3.4 percent for 2006, as compared to 3.2 percent for 2005. As the PVC and PE resin industries have recovered from the hurricane related disruptions during the fourth quarter of 2005 and the first quarter of 2006, supply and demand of pipe have moved to a more balanced situation. As demand declined during the fourth quarter, our margins also declined from the first part of the year. As PVC resin and pipe prices continue the recent downward trend, our margins in the first quarter of 2007 may also decline further, but seasonal demand should increase as usual during the spring and summer months.

We provide a more detailed discussion of PVC and PE resin prices, GDP, and demand for PVC and PE pipe products under the *Future Outlook and Risks to Our Business* section of this discussion below, and under *Item 1A. Risk Factors*. We will comment in more detail on our Consolidated Results of Operations, Results of Operations by Segment, and Liquidity and Capital Resources in each of those respective sections below.

## Consolidated Results of Operations

**Years ended December 31**  
(in thousand, except for per share amounts)

				<b>Percent Change</b>	
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>06 vs 05</u>	<u>05 vs 04</u>
Net sales	\$ 714,112	\$ 694,244	\$ 474,954	2.9%	46.2%
Cost of goods sold	<u>539,470</u>	<u>534,855</u>	<u>404,818</u>	0.9%	32.1%
Gross profit	<u>174,642</u>	<u>159,389</u>	<u>70,136</u>	9.6%	127.3%
Gross profit margin	24.5%	23.0%	14.8%		
Operating expenses:					
Freight expenses	38,897	38,687	30,950	0.5%	25.0%
Selling expenses	18,194	17,719	14,778	2.7%	19.9%
General and administrative expenses	17,301	15,973	11,114	8.3%	43.7%
Restructuring expenses	--	--	1,608	*	*
Other expense (income)	311	(1,771)	408	*	*
Total operating expenses	<u>74,703</u>	<u>70,608</u>	<u>58,858</u>	5.8%	20.0%
Operating income	<u>99,939</u>	<u>88,781</u>	<u>11,278</u>	12.6%	687.2%
Gain on sale of investee and non-operating income	897	18,363	--	*	*
Interest expense	(3,800)	(27,051)	(20,668)	-86.0%	30.9%
Income (loss) from continuing operations before income taxes	<u>97,036</u>	<u>80,093</u>	<u>(9,390)</u>	21.2%	953.0%
Income tax (expense) benefit	(36,341)	(32,915)	3,059	*	*
Effective tax rate	37.5%	41.1%	32.6%		
Minority interest	--	(228)	173	*	*
Equity in undistributed earnings of unconsolidated affiliate, net of tax	--	--	618	*	*
Income (loss) from continuing operations	60,695	46,950	(5,540)	29.3%	947.5%
Income from discontinued operations, net of tax	--	--	--	--	--
Net income (loss)	<u>\$ 60,695</u>	<u>\$ 46,950</u>	<u>\$ (5,540)</u>	<u>29.3%</u>	<u>947.5%</u>

\* Percentage not applicable or meaningful.

### *Net Sales:*

During 2006, both demand for and prices of PVC pipe have decreased from the levels seen at the end of 2005. While net sales increased by \$19.9 million in 2006 compared to 2005, volume decreased by 9%. Average selling prices remained high during the first nine months of the year resulting in the overall increase. Sales prices have declined in the fourth quarter of 2006 and continue to decline into the first quarter of 2007, which is expected to result in lower overall sales in the first quarter of 2007 compared to the first quarter of 2006.

Net sales increased by \$219.3 million in 2005 compared to 2004. Of this increase, \$166.4 million was due to higher volume and pricing in our PVC products, \$46.8 million was due to the UAC acquisition in our PE business in late 2004, and the balance of \$6.1 million was due to volume and pricing in our other PE products. The PVC increase was due in large part to pricing increases. The average selling prices were above 2004 averages for all of the year, but were particularly higher during the fourth quarter of 2005. This increase in prices resulted from the PVC resin manufacturing and supply disruptions,

caused by hurricanes Katrina and Rita which led to a situation where demand for PVC pipe exceeded supply. See *Note 2: Acquisitions and Divestitures* in the Notes to the Consolidated Financial Statements for further discussion of the UAC acquisition.

*Gross Profit:*

The gross profit improvements as a percentage of sales during the last two years are primarily due to the increasing spread of selling prices over the cost of raw materials in our PVC business. With the recent decline of average selling prices, however, our gross profit may be lower in the first quarter of 2007 than in the first quarter of 2006.

*Operating Expenses:*

Operating expenses increased by \$4.1 million in 2006 compared to 2005. Freight increased by \$0.2 million due to the overall higher costs for freight in rates per pound even though the volume was lower.

Selling, general and administrative costs increased by \$1.8 million in 2006 compared to 2005. There were several contributing factors to this increase: termination fees paid to Spell Capital Partners in 2006 amounted to \$1.4 million; non-cash compensation costs were \$3.4 million (primarily from FAS 123(R) costs); and consulting fees for Synergetics Installations Worldwide, Inc., a management consulting firm (Synergetics”), were \$0.8 million. These increased costs were partially offset by a reduction in USPoly administrative costs of \$1.8 million resulting from the consolidation of USPoly’s administrative offices with PW Eagle’s administrative offices, and sales commissions were \$1.1 million lower due to the reduced sales volume. See *Note 2: Acquisitions and Divestitures* in the Notes to the Consolidated Financial Statements for further discussion of the USPoly merger with and into PW Eagle.

Other income and expense includes non-cash costs of \$0.7 million for the previously announced relocation of USPoly’s injection molding operations, which occurred in the second quarter; and 2005 included a gain on the sale of land of \$0.5 million and a gain on the sale of the metals parts business of \$1.2 million.

Comparing 2005 to 2004, operating expenses increased by \$11.7 million. Freight and selling costs increased by \$10.7 million due to the overall volume increases and higher selling prices, and higher costs for freight both in rates per pound and special handling charges when the industry experienced shortages of available trucks. General and administrative costs increased by \$4.9 million, including a \$2.2 million increase in our PE products business, due largely to the UAC acquisition. The remaining increase in administrative costs was due to several items including higher overall compensation costs based on the improvement in profitability and higher professional service fees, among others. These increases were partially offset by a \$0.5 million gain on the sale of land and the absence of any restructuring costs in 2005, and also because 2004 included a loss on the sale of facilities of \$0.4 million. In addition, our PE business realized a gain on the sale of its metals parts business of \$1.2 million in the second quarter of 2005.

*Gain on Sale of Investee and Non-operating Income:*

For 2006, non-operating income includes a gain on put options related to the Company's share repurchase program of \$0.4 million, and an adjustment to the gain on W.L. Plastics of \$0.5 million.

In 2005, USPoly sold its approximately 23% interest in W.L. Plastics. USPoly received \$23.5 million cash and an additional \$1.2 million is being held in escrow for a period of 18 months and is subject to customary post-closing contingencies. As a result of this sale USPoly recorded a gain in 2005 of \$18.4 million.

*Interest Expense:*

Interest expense decreased \$23.3 million in 2006 compared to 2005, primarily due to our repayment of outstanding debt in 2005. In addition, net interest expense was reduced by \$0.8 million of interest income earned on temporary cash investments during 2006.

Interest expense increased \$6.4 million in 2005 compared to 2004. Included in 2005 was \$4.8 million of prepayment penalties associated with our payment of all subordinated debt and term loans, and non-cash charges of \$2.8 million for the related write-off of unamortized debt discount and deferred finance charges. In addition, there was an additional \$5.1 million of non-cash charges for the fair value adjustments for warrants issued with the subordinated debt.

See *Note 5: Financing Arrangements* in the Notes to the Consolidated Financial Statements for further discussion of related debt transactions.

*Income Taxes:*

The income tax provision (benefit) for the years ended December 31, 2006, 2005 and 2004 was calculated based on management's estimates of the annual effective tax rate for each year. The annual differences in 2005 from our usual tax rate of approximately 38-39% are primarily due to permanent differences from charges related to the stock warrants.

## Results of Operations by Segment

	<b>Years ended December 31</b>				
	(in thousand, except for per share amounts)				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<b>Percent Change</b>	
				<u>06 vs 05</u>	<u>05 vs 04</u>
Net sales:					
PVC products	\$ 631,901	\$ 612,258	\$ 445,880	3.2%	37.3%
PE products	82,211	81,986	29,074	0.3%	182.0%
Consolidated net sales	<u>714,112</u>	<u>694,244</u>	<u>474,954</u>	2.9%	46.2%
Operating income:					
PVC products	94,354	84,387	11,140	11.8%	657.5%
<i>% of sales</i>	<i>14.9%</i>	<i>13.8%</i>	<i>2.5%</i>		
PE products	5,585	4,394	138	27.1%	3,084.1%
<i>% of sales</i>	<i>6.8%</i>	<i>5.4%</i>	<i>0.5%</i>		
Consolidated operating income:	<u>99,939</u>	<u>88,781</u>	<u>11,278</u>	12.6%	687.2%
<i>% of sales</i>	<i>14.0%</i>	<i>12.8%</i>	<i>2.4%</i>		
Gain on sale of investee and non-operating income	897	18,363	--		--
Interest expense	(3,800)	(27,051)	(20,668)	-86.0%	30.9%
Income (loss) before income taxes, minority interest and equity in undistributed earnings of unconsolidated affiliate	\$ 97,036	\$ 80,093	\$ (9,390)	21.2%	953.0%

### *PVC Products:*

PVC sales increased \$19.6 million in 2006 compared to 2005 due to higher selling prices, which more than offset a 9% decrease in volume. While selling prices declined in 2006 compared to the fourth quarter of 2005, they remain well above the average for 2005. Margins during the first three quarters of 2006 remained well above 2005 as product demand was relatively strong, yielding an improved gross profit level.

Operating expenses increased \$4.2 million in 2006 over 2005. There were several significant contributing factors to this increase: freight costs increased \$0.4 million due to higher transportation rates; selling commissions decreased \$1.1 million due to the lower volume; termination fees paid to Spell Capital Partners pursuant to the Management Services Agreement amounted to \$1.2 million; non-cash compensation costs were \$3.4 million (primarily from FAS 123(R) costs); consulting fees for Synergetics were \$0.8 million; and 2005 included a gain on the sale of land of \$0.5 million. The overall result was an increase in operating income of \$10.0 million.

PVC sales increased \$166.4 million from 2004 to 2005, due to an overall volume increase of 3.4%, amounting to \$15.1 million of the sales increase, and average pricing increases amounting to \$151.3 million. Most of our plants were operating at near capacity levels for much of 2005. The average selling prices were above 2004 averages for most of the year, but were particularly higher during the fourth quarter of 2005. The fourth quarter increase in prices resulted from the PVC industry manufacturing and resin supply disruptions, which were caused by the hurricanes Katrina and Rita.

The spread of selling prices over the cost of raw materials increased throughout 2005, and particularly in the fourth quarter, resulting in better gross margins. Operating expenses increased by \$7.0 million in 2005 compared to 2004. Freight and selling costs increased by \$6.7 million due to the higher sales and higher freight rates during the year, and general and administrative expenses increased \$2.7 million. These increases were partially offset by not incurring any restructuring costs in 2005, by a gain on sale of land of \$0.5 million in 2005, and 2004 included a loss on sale of facilities of \$0.4 million. The result was an increase in operating income of \$73.2 million from 2004 to 2005.

### *PE Products:*

PE sales increased \$0.2 million in 2006 compared to 2005. Increases in selling prices more than offset a 12% reduction in volume. The increased sales and reduced material costs resulted in a small increase in our gross margin percentage. Operating expenses decreased by \$0.1 million. General and administrative costs declined \$1.8 million as a result of USPoly's consolidation with PW Eagle; 2005 had included a gain on sale of the metals business of \$1.2 million; and 2006 includes the costs for relocation of the injection molding operations of \$1.0 million. Freight costs decreased by \$0.2 million

with higher transportation rates offsetting the lower volume. The overall result was an increase in operating income of \$1.2 million.

PE sales increased \$52.9 million from 2004 to 2005. Sales from the UAC acquisition late in the third quarter of 2004 contributed \$46.8 million of the increase, along with increases in the other PE products of \$6.1 million. Overall volume of pounds sold increased 166%, and average selling prices increased over 6%. Gross margins improved due to the volume increase overall, while the gross margins as a percentage of net sales stayed about the same. Operating expenses increased by \$4.9 million in 2005 compared to 2004. This is primarily due to inclusion for the year of the costs associated with business acquired from UAC, as well as higher freight and commission costs for the higher sales volume. These cost increases were partially offset by the gain on the sale of the metals parts business of \$1.2 million in the second quarter of 2005. The result was an increase in operating income of \$4.3 million from 2004 to 2005.

### **Liquidity and Capital Resources**

Our primary sources of liquidity and capital resources are cash generated from operations, and additional availability under our revolving credit facility.

Cash provided by operating activities was \$50.5 million in 2006 compared to \$85.3 million in 2005. Cash generated from operations in 2006 included net income of \$60.7 million, offset by net changes in operating assets and other non-cash items. Included within the changes in operating assets and liabilities in 2006 are tax payments totaling \$53.3 million. These tax payments included our payment of 2005 taxes of \$21.8 million as well as estimated tax payments for 2006.

Investing activities used \$6.2 million of cash in 2006, compared to \$20.5 million provided by investing activities in 2005. The 2006 amount used was for capital expenditures of \$7.6 million, offset by proceeds of \$0.9 million from the sale of the Shawnee facility, and an additional \$0.5 million from the sale of W.L. Plastics.

Financing activities used \$11.9 million of cash in 2006 compared to \$101.1 million used in 2005. The significant uses in 2006 include a net decrease in our revolving credit facility of \$7.2 million, the repurchase of company shares of \$16.4 million, and \$3.6 million in dividend payments. These were offset by the proceeds and tax benefits from exercises of stock options, restricted stock and warrants which provided a total of \$15.3 million and proceeds of \$0.4 million from our sale of put options related to our share repurchase program. In June 2006, the Board of Directors authorized a repurchase of up to \$40 million of our outstanding shares. This repurchase activity continued during the first quarter of 2007. During the months of January and February, 2007, the Company repurchased an additional 460,749 shares of PW Eagle, Inc. common stock for approximately \$15.1 million in accordance with the provisions of the approved share repurchase program (see Note 14 of the Notes to the Condensed Consolidated Financial Statements). With the inclusion of these shares, the Company has repurchased 990,614 shares of our common stock for \$31.5 million. The Rule 10b5-1 purchase plan entered into on August 21, 2006 provided for \$31.5 million of share repurchases. Therefore, since the maximum dollar common stock share repurchases has been completed under this plan, there will not be additional share repurchases forthcoming under the Rule 10b5-1 plan.

We had working capital of \$99.5 million at December 31, 2006, which is an increase of \$61.2 million from the \$38.3 million at December 31, 2005. This improvement is the result of our continued high levels of profitability in 2006, and the resulting positive cash flow from operations of \$50.5 million for the year ended December 31, 2006.

In addition to the improvement in working capital, we had additional availability on our revolving credit facilities of approximately \$97 million at December 31, 2006.

Total assets of \$242.6 million at December 31, 2006 represented a \$8.1 million increase from the \$234.5 million at December 31, 2005. This increase was from current assets, with cash increasing by \$32.4 million, accounts receivable decreasing by \$26.7 million and inventories increasing by \$4.8 million. Property and equipment decreased \$3.7 million as depreciation and the sale of the Shawnee, Oklahoma facility more than offset our capital expenditures. Total capitalization at December 31, 2006 was \$164.9 million, consisting of \$19.5 million of debt and \$145.4 million of equity, with debt decreasing by \$9.1 million and equity increasing by \$59.4 million from December 31, 2005 amounts.

The decrease in accounts receivable was due to lower selling prices and volumes in the fourth quarter 2006 compared to the fourth quarter of 2005. Inventories were higher at the end of 2006 as our overall inventory levels at the end of 2005 were very low due to the unusually high demand in the fourth quarter of 2005. We resumed more normal inventory levels in 2006.

Capital spending for property and equipment was \$7.6 million in 2006, primarily for equipment maintenance and upgrades, and completing a new Ultra product manufacturing line. Under the recently announced merger agreement with JMM, capital spending for 2007 up to the closing date is limited to \$1.2 million plus completion of existing projects.

Management believes that, for the foreseeable future, the Company can fund requirements for working capital, capital expenditures and other obligations with cash generated from operations and borrowing from existing credit facilities.

### Credit Facilities

A summary of amounts outstanding under each of our credit facilities at December 31, 2006 and December 31, 2005 follows (in thousands):

	<b>December 31, 2006</b>	<b>December 31, 2005</b>
Borrowings under revolving credit facilities		
PW Eagle	\$ —	\$ 7,184
USPoly	—	—
Total amounts outstanding under revolving credit facilities	<u>\$ —</u>	<u>\$ 7,184</u>
Long-term debt, net of discounts		
PW Eagle Capital Lease Obligation	\$ 16,211	\$ 16,353
USPoly Capital Lease Obligations	3,315	3,354
Total amounts outstanding under long-term credit facilities	<u>19,526</u>	<u>19,707</u>
Total amounts outstanding	<u>\$ 19,526</u>	<u>\$ 26,891</u>

Further information on the Company's financing arrangements can be found in *Note 5 Financing Arrangements* in the Notes to the Consolidated Financial Statements.

The Company's obligations at December 31, 2006 under its financing arrangements are summarized in the table below:

<b>Scheduled Contractual Obligations</b>	<b>Total</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>After 5 Years</b>
Capital lease obligations	\$ 42,398	\$ 2,633	\$ 2,633	\$ 2,633	\$ 2,618	\$ 2,618	\$ 29,263
Operating leases	2,816	943	752	719	400	2	—
Estimated interest on revolving credit facilities	—	—	—	—	—	—	—
	<u>\$ 45,214</u>	<u>\$ 3,576</u>	<u>\$ 3,385</u>	<u>\$ 3,352</u>	<u>\$ 3,018</u>	<u>\$ 2,620</u>	<u>\$ 29,263</u>

There is no estimated interest on revolving debt as there was no such debt outstanding at December 31, 2006. We had commitments for capital expenditures of \$2.5 million at December 31, 2006, which we intend to fund from our revolving credit facilities, or cash flow from operations.

At December 31, 2006, the Company had a contingent liability for standby letters of credit totaling \$3.1 million that are issued and outstanding. These letters of credit guarantee payment to third parties in the event the Company is unable to pay in a timely manner. Standby letters of credit reduce the funds available under the revolving credit facility. No amounts were drawn on these letters of credit as of December 31, 2006.

Under current financing agreements, PW Eagle is required to comply with a minimum fixed charge coverage ratio, if average availability for the sixty day period then ended is less than \$40 million or if at any time within the fiscal quarter availability under the revolving credit facility is less than \$30 million. This covenant did not apply as our availability exceeded these minimum amounts. Some of the capital lease obligations also contain covenants that mirror the senior debt covenants. At December 31, 2006, PW Eagle was in compliance with all debt covenants.

## **Restructuring Activities**

Effective January 2004, the corporate office in Minneapolis, Minnesota was closed and all corporate office functions were transferred to the Eugene, Oregon office. As a result of the consolidation, approximately 30 positions were eliminated. In addition, certain officers and directors resigned their positions and cancelled consulting agreements. In connection with the officer resignations, the Board of Directors modified certain outstanding restricted stock and stock option awards effective January 2, 2004. The modifications allow for continued vesting of the stock awards, which would have been forfeited upon the officers' resignation under the original terms, resulting in a charge of \$0.5 million. During 2004, the Board of Directors approved the payment of management bonuses of \$1.0 million for the successful restructuring of the Company. The recipients of the management bonus elected to receive \$0.8 million in PW Eagle common stock and \$0.2 million in cash.

In connection with these activities, we incurred restructuring charges of \$1.6 million in 2004. At December 31, 2004, we had \$0.1 million of severance payments remaining from the restructuring, which were paid in 2005.

## **Future Outlook and Risks to Our Business**

The statements contained in this section and statements contained in Items 1, 1A, 3, 7 and 7A of this Report on Form 10-K regarding our beliefs and expectations that are not strictly historical are forward-looking statements made under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements reflect our current expectations and beliefs as of March 9, 2007 and are based on information known to us, and our assumptions as of that date. These forward-looking statements involve known and unknown business risks and risks that we cannot control. As a result, statements regarding our expectations may prove to be inaccurate and our operating results may differ materially from our stated expectations and beliefs. For a discussion of the risks facing our business, please see *Item 1.A Risk Factors*.

Some of our current beliefs and expectations are discussed below.

### *Forward Looking Statements*

PVC and PE resin manufacturers were significantly impacted by Hurricanes Katrina and Rita during the third quarter of 2005. Manufacturing plants in both Louisiana and Texas ceased operating during the storms and curtailed production thereafter due to lack of utilities and/or raw material supply. The subsequent difficulties with the rail service made the situation worse. Also, one manufacturer experienced production disruptions as a result of an accident and fire at one of its facilities. All major suppliers declared *force majeure* and for a period of time supplied customers on some form of allocation. These interruptions in supply resulted in significant price increases in both PE and PVC resin.

In light of the potential supply disruptions, PVC and PE pipe buyers accelerated their purchasing patterns, resulting in a very strong demand surge in September 2005 that continued into the fourth quarter of 2005. Faced with this strong demand, limited raw material supply and rising costs, we and many other pipe manufacturers implemented multiple price increases. Because we were able to increase prices at a rate ahead of increasing resin costs, we improved gross margins as well, resulting in strong sales volumes and high gross margins in the fourth quarter of 2005.

Most of the disruption in supply of PVC and PE resin caused by Hurricanes Katrina and Rita was resolved by the end of 2005, resulting in increased availability of, and decreasing prices for, resin. Starting in December 2005 and continuing through the first few months of 2006, PVC resin prices decreased and then stabilized during the second and third quarters before decreasing substantially during the fourth quarter of 2006. Prices for PVC pipe declined somewhat in the first part of 2006, stabilizing during the second and third quarters. Similar to the trend for PVC resin, PVC pipe prices decreased rapidly in the fourth quarter of 2006. Historically, during times of decreasing PVC resin prices, PVC pipe prices have decreased faster than raw material costs, resulting in lower margins and this occurred in the fourth quarter of 2006. Our business and the PVC pipe industry in general is subject to seasonality as residential and commercial construction activity typically declines in the fourth quarter. The fourth quarter of 2006 saw demand decrease somewhat more than the typical seasonal slowdown, which we believe was due to efforts by our distributors to reduce their inventory levels as pipe prices were decreasing during the quarter.

Industry expectations are for PVC resin prices to remain relatively stable in the first quarter of 2007, and producers have announced a price increase for March 2007. We expect our margins to remain near their current levels as the price of PVC resin stabilizes. Demand has increased in the early first quarter of 2007 compared to the fourth quarter of 2006 as distributors have resumed more normal buying patterns.

The short term expectations described above may be mitigated to some extent by the following broader trends in our business. We expect the demand for plastic pipe to grow as acceptance of plastic pipe over metal pipe continues and the overall economy continues to grow. We believe that the Gross Domestic Product (GDP) is closely correlated to the demand for PVC and PE pipe, and we recognize that our business is tied to economic cycles. GDP is reported to have grown at an annual rate of 3.2% in 2005 and 3.4% in 2006. Industry growth projections call for annual sales growth rates for PVC pipe of 3% or greater in 2007. The actual growth rate may be less or greater than 3% based on short-term economic conditions. Our strategy has been, and continues to be, to concentrate growth initiatives in higher profit products and geographic regions.

We have a long-term contract with one supplier for PVC resin, our primary raw material, and are substantially dependent on that relationship. The terms of our long-term agreement with our PVC supplier provide, among other things, for the extension of the agreement at the supplier's option through 2013, certain termination rights exercisable by the supplier without corresponding rights for us, a right of first negotiation with the supplier on the sale of the assets of one or more of our facilities that utilize PVC resin, and the supplier's option to require a buyer of all or a substantial portion of our assets to assume the agreement. These provisions may have the effect of limiting our ability to replace the supplier, procure PVC resin under more favorable terms or divest of our assets.

### **Critical Accounting Estimates**

Management's discussion and analysis of its financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported revenues and expenses during the reporting period. Management bases these estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the recorded values of certain assets and liabilities. Actual results could differ from these estimates.

Management believes the Company's critical accounting policies and areas that require more significant judgments and estimates used in the preparation of its financial statements include:

#### *Allowance for Doubtful Accounts and Sales Discounts*

We maintain an allowance for doubtful accounts at a level estimated to be sufficient to absorb future losses due to accounts that are potentially uncollectible. The allowance is based on our historical experience, prior years' write-offs, aging of past due accounts, financial condition of the customer and the general economic conditions of our market place. Actual results could differ from these estimates resulting in an increase to the allowance for doubtful accounts and bad debt expense. We wrote-off \$0.2 million of uncollectible accounts during 2006, \$0.1 million during 2005, and \$0.2 million during 2004, while our charges to bad debt expenses amounted to \$0.2 million in 2006, \$0.5 million in 2005, and \$0.1 million in 2004. Our allowance for doubtful accounts was \$1.0 million at December 31, 2006 and \$1.0 million at December 31, 2005. Had our actual write-offs been significantly higher, or had the aging deteriorated, we may have required a larger allowance at December 31, 2006.

We also maintain an allowance for sales discounts. This allowance is based on our historical experience of discounts given, and current terms of sale. The total discounts are deducted from gross sales. The dollar amount of such discounts is directly related to total gross sales, and the related terms of sale of such transactions. The allowance amount for sales discounts was \$0.7 million at December 31, 2006 and \$1.0 million at December 31, 2005.

#### *Inventories*

Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method and includes materials, labor and manufacturing overhead. Judgment by management is required to determine both replacement cost and market. We recorded a lower of cost or market adjustment in the fourth quarter of 2006, reducing pipe inventory values by \$2.4 million. No lower of cost or market adjustment was required at either December 31, 2005 or 2004. A change in this management estimate would impact cost of goods sold and the inventory carrying value.

### *Long-lived Assets*

Management periodically reviews its long-lived and intangible assets and goodwill for impairment and assesses whether significant events or changes in business circumstances indicate that the carrying value of the assets may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the anticipated future undiscounted cash flows expected to result from the use of that asset and its eventual disposition. The amount of the impairment loss to be recorded, if any, is calculated by the excess of the asset's carrying value over its estimated fair value. Management also periodically reassesses the estimated remaining useful lives of its long-lived assets. Changes to either estimated future undiscounted cash flows or useful lives would impact the amount of depreciation and amortization expense recorded in earnings.

### *Accounting for Income Taxes*

Significant judgment by management is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. As part of the process of preparing our financial statements, management is required to estimate income taxes in each of the jurisdictions in which we operate. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities, which are included within our balance sheet. Management must then assess the likelihood that deferred tax assets will be recovered from future taxable income and, to the extent management believes that recovery is not likely, a valuation allowance must be established. To the extent that a valuation allowance is established or increased, an expense within the tax provision is included in the Consolidated Statement of Operations.

### *Insurance Liability*

We self-insure a significant portion of our employees for health and dental related claims and record a claims liability based on claims history. The liability is based on analysis of our historical claim activity and reporting trends. While management believes that the insurance liability is adequate at year-end, results could be materially different if historical trends do not reflect actual results. A summary of self-insured medical/dental insurance activity follows:

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net liability for medical/dental insurance – beginning of year	\$ 1,178	\$ 991	\$ 528
Accruals for medical/dental insurance during the year	5,163	6,396	4,238
Net medical/dental insurance payments	<u>(5,592)</u>	<u>(6,209)</u>	<u>(3,775)</u>
Net liability for medical/dental insurance – end of year	\$ 749	\$ 1,178	\$ 991

### *Worker's Compensation Liability*

We maintain an insurance liability, which is deducted from our premium deposits, for incurred and not paid and incurred but not reported employee related injuries. The liability is based on analysis of our historical claim activity and reporting trends. While management believes that the worker's compensation liability is adequate at year-end, results could be materially different if historical trends do not reflect actual results. A summary of our insured worker's compensation activity follows:

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net liability (deposit) for worker's compensation – beginning of year	\$ 270	\$ (300)	\$ 251
Accruals for worker's compensation during the year	717	978	482
Net payments for insurance premiums and claims	<u>(874)</u>	<u>(408)</u>	<u>(1,033)</u>
Net liability (deposit) for worker's compensation – end of year	\$ 113	\$ 270	\$ (300)

### *Warranty Liability*

The provision for expenses related to product warranty is reviewed regularly. Warranty liabilities are estimated using historical information on the frequency and average cost of warranty claims. Management studies trends of warranty claims to improve pipe quality, pipe installation techniques and minimize future claims. While management believes that the

warranty liability is adequate at year-end, results could be materially different if historical trends do not reflect actual results. A summary of warranty related activity follows:

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Accrual for product warranties – beginning of year	\$ 325	\$ 325	\$ 450
Accruals for warranties issued during the year	565	305	328
Settlements made during the year	<u>(615)</u>	<u>(305)</u>	<u>(453)</u>
Accrual for product warranties – end of year	\$ 275	\$ 325	\$ 325

#### *Share-based compensation*

The Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 123(R) eliminating the alternative to use the intrinsic value method of accounting that was provided in SFAS No. 123, which generally resulted in no compensation expense recorded in the financial statements related to the issuance of equity awards to employees and directors. SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS No. 123(R) establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all companies to apply a fair-value-based measurement method in accounting generally for all share-based payment transactions with employees. In accordance with the new rule, the Company adopted SFAS No. 123(R) using a modified prospective method for the recognition of share-based compensation expense on January 1, 2006.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards.” The Company has elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to FAS 123(R). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of FAS 123(R).

Under FAS 123(R), share-based compensation cost is measured at the grant date, based on the estimated fair value of the award and is recognized as expense over the stated vesting period. The Company continues to use the Black-Scholes option-pricing model as its method for valuing stock options. The key assumptions for this valuation method include the expected term of the option, stock price volatility, risk-free interest rate, dividend yield, exercise price and forfeiture rate. Many of these assumptions are judgmental and highly sensitive in the determination of compensation expense. Further information on the Company’s share-based payments can be found in Note 13 in the Notes to the Consolidated Financial Statements under ITEM 8.

#### **Recently Issued Accounting Standards**

##### *SFAS No. 158*

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans,” which requires employers to recognize on their balance sheets the funded status of pension and other postretirement benefit plans, effective December 31, 2006 for calendar year-end companies. In addition SFAS No. 158 requires fiscal year-end measurement of plan assets and benefit obligations, eliminating the use of earlier measurement dates currently permissible, effective for fiscal years ending after December 15, 2008. We do not have any defined benefit pension or other postretirement plans and, accordingly, the adoption of the provisions of SFAS No. 158 did not have any effect on our financial position or results of operations.

##### *SFAS No. 157*

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements,” which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair-value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. While we are still analyzing the effects of applying SFAS No. 157, we believe that the adoption of SFAS No. 157 will not have a material effect on our financial position or results of operations.

##### *Staff Accounting Bulletin No. 108*

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,” which addresses how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in current-year financial statements. SAB No. 108 requires companies to quantify misstatements using both the balance sheet and income statement approaches and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The implementation of SAB No. 108 did not have any effect on our financial position or results of operations.

#### *FASB Staff Position No. AUG AIR-1*

In September 2006, the FASB issued Staff Position No. AUG AIR-1, “Accounting for Planned Major Maintenance Activities,” which prohibits accruing for the future cost of periodic major overhauls and planned maintenance of plant and equipment in annual and interim periods. This Staff Position is effective for fiscal years beginning after December 15, 2006 and must be retrospectively applied. We do not accrue for such costs in annual or interim periods and, accordingly, the adoption of this Staff Position will not have any effect on our financial position or results of operations.

#### *FASB Interpretation No. 48*

In July 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes,” which defines the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority. FIN No. 48 applies to all tax positions accounted for under SFAS No. 109, “Accounting for Income Taxes.” FIN No. 48 is effective as of the beginning of the first fiscal year beginning after December 15, 2006. Upon adoption, the Company will adjust the financial statements if needed to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any adjustment will be recorded directly to our beginning retained earnings balance in the period of adoption and reported as a change in accounting principle. The Company is currently analyzing the effects of adopting Interpretation No. 48.

### **Related Party Transactions**

Certain former members of the Company’s Board of Directors were members of Spell Capital Partners, LLC (Spell Capital). On March 30, 2006, the Company terminated its Management Services Agreement (the Agreement), dated January 1, 2004 with Spell Capital, pursuant to which Spell Capital provided the Company with supervisory and monitoring services, as well as advice and assistance with acquisitions, divestitures and financing activities. The Agreement was terminated based on a determination by the Board of Directors that the Company no longer required the services of Spell Capital. The terms of the Agreement permitted the Company to not renew the Agreement upon the conclusion of any quarterly term of the Agreement in exchange for a payment to Spell Capital equal to the monthly management fee currently due and owing to Spell Capital along with a payment equal to twenty-four (24) times the current monthly management fee. The amount of the termination payment paid by the Company to Spell Capital was \$1,248,000. The Company’s wholly-owned subsidiary, USPoly Company, LLC, also terminated its Management Services Agreement with Spell Capital. The amount of the termination payment paid by USPoly to Spell Capital was \$112,500. These termination fees are included in General and Administrative expenses.

Costs incurred under these arrangements, prior to their termination discussed above, of \$0.2 million, \$0.8 million and \$0.7 million in 2006, 2005 and 2004, respectively, are included in General and Administrative expenses in the consolidated statement of operations. In the fourth quarter of 2005, the Board of Directors approved a bonus payment to Spell Capital of \$0.7 million, which was also included in General and Administrative expenses in the consolidated statement of operations.

During 2004, PW Eagle paid certain operating expenses for USPoly. Transactions with USPoly included the rental of certain operating facilities and expenses related to certain services provided to and delivered by PW Eagle. At December 31, 2004, the inter-company balance was approximately \$0.1 million. On October 17, 2005, USPoly was merged into PW Eagle. All inter-company transactions are eliminated in the consolidated financial statements.

In connection with the UAC Acquisition, USPoly paid Spell Capital a fee of \$0.5 million which is included in transaction costs.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We were not exposed to any market risks on variable rate debt obligations at December 31, 2006, as we had no such obligations outstanding. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates. Market risk is estimated as the potential increase in interest expense resulting from a hypothetical one percent increase in interest rates.

From time to time, we enter into financial instruments to manage and reduce the impact of changes in interest rates on our Senior Credit Facility. At December 31, 2006, we had no outstanding interest rate derivatives.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and the Stockholders of PW Eagle, Inc.:

We have audited the accompanying consolidated balance sheet of PW Eagle, Inc. and its subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the two years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PW Eagle, Inc. and its subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123(R), Share-Based Payments (Revised 2004) during 2006.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial statement schedule listed in the index at Item 15 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

We also have audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the effectiveness of PW Eagle, Inc and its subsidiary's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 14, 2007, expressed an unqualified opinion thereon.

/s/ Grant Thornton LLP

Portland, Oregon  
March 14, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of PW Eagle, Inc.

In our opinion, the consolidated statements of operations, of stockholders' equity and comprehensive income and of cash flows for the year ended December 31, 2004 present fairly, in all material respects, the results of operations and cash flows of PW Eagle, Inc. and its subsidiary, for the year ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

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PricewaterhouseCoopers LLP  
Minneapolis, Minnesota

March 25, 2005

**PW EAGLE, INC.****CONSOLIDATED STATEMENT OF OPERATIONS** (in thousands, except for per share amounts)

	Years ended December 31		
	2006	2005	2004
Net sales	\$ 714,112	\$ 694,244	\$ 474,954
Cost of goods sold	539,470	534,855	404,818
Gross profit	174,642	159,389	70,136
Operating expenses:			
Freight expense	38,897	38,687	30,950
Selling expense	18,194	17,719	14,778
General and administrative expense	17,301	15,973	11,114
Restructuring and related costs	—	—	1,608
Other (income) expense, net	311	(1,771)	408
	74,703	70,608	58,858
Operating income	99,939	88,781	11,278
Gain on sale of investee and non-operating income	897	18,363	—
Interest expense	(3,800)	(27,051)	(20,668)
Income (loss) before income taxes, minority interest and equity in undistributed earnings of unconsolidated affiliate	97,036	80,093	(9,390)
Income tax (expense) benefit	(36,341)	(32,915)	3,059
Minority interest in USPoly Company	—	(228)	173
Equity in undistributed earnings of unconsolidated affiliate, net of tax	—	—	618
Net income (loss)	\$ 60,695	\$ 46,950	\$ (5,540)
Net income (loss) per share:			
Basic	\$ 5.09	\$ 5.28	\$ (0.78)
Diluted	\$ 5.02	\$ 4.65	\$ (0.78)
Cash dividends declared per common share	\$ 0.30	\$ 0.075	\$ —
Weighted average number of common shares outstanding:			
Basic	11,930	8,888	7,096
Diluted	12,096	10,094	7,096

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

**PW EAGLE, INC.**  
**CONSOLIDATED BALANCE SHEET** (in thousands, except for share data)

At December 31,	2006	2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 38,064	\$ 5,671
Accounts receivable, net	60,337	87,062
Inventories	68,990	64,239
Deferred income taxes	3,284	2,382
Other current assets	2,468	2,861
Total current assets	173,143	162,215
Property and equipment, net	52,626	56,301
Goodwill	6,441	6,441
Deferred tax asset	1,745	325
Intangible assets	3,064	4,020
Other assets	5,555	5,154
Total assets	\$ 242,574	\$ 234,456
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Borrowings under revolving credit facilities	\$ —	\$ 7,184
Current maturities of capital lease obligations	224	182
Accounts payable	50,749	68,483
Book overdraft	—	192
Accrued liabilities	22,665	47,907
Total current liabilities	73,638	123,948
Capital lease obligations, less current maturities	19,302	19,525
Other long-term liabilities	4,237	4,944
Total liabilities	97,177	148,417

Commitments and contingencies (Notes 6 and 8)

Stockholders' equity:

Series A preferred stock, 7% cumulative dividend; convertible; \$2 per share liquidation preference; no par value; authorized 2,000,000 shares; none issued and outstanding	—	—
Undesignated stock, par value \$0.01 per share; authorized 14,490,000 shares; none issued and outstanding	—	—
Stock warrants	2,953	5,844
Common stock, par value \$0.01 per share; authorized 30,000,000 shares; issued and outstanding 11,965,403 and 11,210,418 shares, respectively	120	112
Class B common stock, par value \$0.01 per share; authorized 3,500,000 shares; none issued and outstanding	—	—
Additional paid-in capital	66,265	61,439
Unearned compensation	—	(326)
Accumulated other comprehensive income	387	372
Accumulated earnings	75,672	18,598
	<hr/>	
Total stockholders' equity	145,397	86,039
	<hr/>	
Total liabilities and stockholders' equity	\$ 242,574	\$ 234,456
	<hr/>	

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

**PW EAGLE, INC.**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
(in thousands)

Years ended December 31, 2006, 2005 and 2004	Stock Warrants	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Unearned Compensation	Notes Receivable from Officers and Employees on Common Stock Purchases	Accumulated Other Comprehensive Income (Loss)	Accumulated (Deficit) Earnings	Total
Balance at December 31, 2003	\$ 6,936	7,259	\$ 73	\$ 31,281	\$ (1,104)	\$ (350)	\$ 371	\$ (21,972)	\$ 15,235
Comprehensive loss:									
Net loss	—	—	—	—	—	—	—	(5,540)	(5,540)
Change in fair value of financial instrument designated as a hedge of interest rate exposure, net of taxes	—	—	—	—	—	—	(37)	—	(37)
Unrealized gain on securities from non-qualified deferred compensation plans	—	—	—	—	—	—	111	—	111
Other comprehensive income									74
Comprehensive loss									(5,466)
Stock warrants issued	82	—	—	—	—	—	—	—	82
Exercised	(62)	15	—	62	—	—	—	—	—
Common stock issued:									
Options exercised	—	110	1	165	—	—	—	—	166
Company sponsored programs	—	133	1	900	310	—	—	—	1,211
Non-qualified stock options tax benefit	—	—	—	8	—	—	—	—	8
Payments received on notes	—	—	—	—	—	95	—	—	95
Stock compensation expense	—	—	—	—	250	—	—	—	250
Other	—	—	—	855	—	177	—	—	1,032
Balance at December 31, 2004	\$ 6,956	7,517	\$ 75	\$ 33,271	\$ (544)	\$ (78)	\$ 445	\$ (27,512)	\$ 12,613
Comprehensive income:									
Net income	—	—	—	—	—	—	—	46,950	46,950

Change in fair value of financial instrument designated as a hedge of interest rate exposure, net of taxes	—	—	—	—	—	—	—	58	—	58
Unrealized gain (loss) on securities from non-qualified deferred compensation plans, net of taxes	—	—	—	—	—	—	—	(131)	—	(131)
Other comprehensive loss										(73)
Comprehensive income										46,877
Stock warrants issued	4,775	—	—	92	—	—	—	—	—	4,867
Exercised	(5,887)	2,302	23	11,658	—	—	—	—	—	5,794
Common stock issued:										
Options exercised	—	32	1	327	—	—	—	—	—	328
Company sponsored programs	—	340	3	3,052	—	—	—	—	—	3,055
Private placement	—	1,019	10	13,119	—	—	—	—	—	13,129
Non-qualified stock options tax benefit	—	—	—	—	—	—	—	—	—	—
Payments received on notes receivable	—	—	—	(80)	—	78	—	—	—	(2)
Stock compensation expense	—	—	—	—	218	—	—	—	—	218
Dividends declared	—	—	—	—	—	—	—	—	(840)	(840)
Balance at December 31, 2005	\$ 5,844	11,210	\$ 112	\$ 61,439	\$ (326)	\$ —	\$ 372	\$ 18,598	\$ 86,039	
Comprehensive income:										
Net income	—	—	—	—	—	—	—	—	60,695	60,695
Other comprehensive income (unrealized gain on securities from non-qualified deferred compensation plans, net of taxes)								15		15
Comprehensive income										60,710
Stock warrants issued	—	—	—	—	—	—	—	—	—	—
Exercised	(2,891)	445	5	5,924	—	—	—	—	—	3,038
Common stock issued:										
Options exercised	—	840	8	4,521	—	—	—	—	—	4,529

Non-qualified stock options tax benefit	—	—	—	7,688	—	—	—	—	7,688
Share based compensation expense	—	—	—	3,100	326	—	—	—	3,426
Dividends declared	—	—	—	—	—	—	—	(3,621)	(3,621)
Shares repurchased	—	(530)	(5)	(16,407)	—	—	—	—	(16,412)
Balance at December 31, 2006	\$ 2,953	11,965	\$ 120	\$ 66,265	\$ —	\$ —	\$ 387	\$ 75,672	\$ 145,397

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

**PW EAGLE, INC.**  
**CONSOLIDATED STATEMENT OF CASH FLOWS** (in thousands)

Years ended December 31,	2006	2005	2004
Cash flows from operating activities:			
Net income (loss)	\$ 60,695	\$ 46,950	\$ (5,540)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
(Gain) loss on disposal of fixed assets	644	(500)	483
Gain on sale of metals parts business	—	(1,256)	—
Gain on sale of investee	(456)	(18,363)	—
Equity in earnings of unconsolidated affiliate, pretax	—	—	(1,002)
Depreciation and amortization	11,077	12,618	11,497
Royalty accretion	949	1,631	772
Warrant fair value adjustment	—	5,067	984
Amortization of debt issue costs, discounts and premiums	359	3,840	7,248
Receivable provisions	(396)	781	2,733
Inventory writedown to estimated market value	2,428	—	—
Deferred income taxes	(2,462)	11,652	(3,195)
Issuance of subordinated debt for interest payment	—	—	1,094
Non-cash minority interest	—	228	(173)
Share-based compensation	3,426	218	1,669
Incremental tax benefits from share based awards	(7,688)	—	—
Investment earnings on deferred compensation plan	26	101	—
Fair value gain for put options	(441)	—	—
Other	—	104	—
Change in assets and liabilities, net of acquisitions			
Accounts receivable	27,121	(33,233)	(13,055)
Income taxes payable	(14,172)	21,716	—
Inventories	(7,179)	(1,365)	(10,849)
Other current assets	393	(1,794)	2,879
Accounts payable	(17,733)	36,969	683
Accrued liabilities	(2,994)	4,302	(4,933)
Other, primarily royalty payments	(3,141)	(4,398)	(1,143)
Net cash provided by (used in) operating activities	<u>50,456</u>	<u>85,268</u>	<u>(9,848)</u>
Cash flows from investing activities:			
Purchases of property and equipment	(7,601)	(4,672)	(1,986)
Purchase of Uponor Aldyl Company	—	—	(13,907)

Purchase of additional equity interest in affiliate	—	(3,169)	(1,550)
Proceeds from sale of metals parts business	—	2,534	—
Proceeds from property and equipment disposals	942	874	2,210
Proceeds from sale of affiliate – W.L. Plastics	456	24,958	—
Payments on notes receivable	—	—	95
Net cash (used in) provided by investing activities	(6,203)	20,525	(15,138)
Cash flows from financing activities:			
Change in cash overdraft	(192)	(1,685)	(4,291)
Borrowings under revolving credit facility	275,984	735,787	596,834
Payments under revolving credit facility	(283,168)	(810,620)	(549,448)
Payment of notes payable	—	(4,461)	—
Proceeds from sale-leaseback transactions	—	—	3,555
Payments on capital lease obligation	(205)	(186)	(222)
Proceeds from long-term debt	—	—	35,875
Repayment of long-term debt	—	(38,073)	(55,093)
Payment of debt issuance costs/financing costs	—	(101)	(3,807)
Dividends paid	(3,564)	—	—
Issuance of common stock upon exercise of stock options and warrants	7,568	327	166
Proceeds from sale of put options	441	—	—
Cash received for USPoly stock	—	—	2,002
Common stock repurchases	(16,412)	—	(30)
Incremental tax benefits from share based awards	7,688	—	—
Proceeds from private sale of stock	—	17,904	—
Net cash (used in) provided by financing activities	(11,860)	(101,108)	25,541
Net change in cash and cash equivalents	32,393	4,685	555
Cash and cash equivalents, beginning of year	5,671	986	431
Cash and cash equivalents, end of year	\$ 38,064	\$ 5,671	\$ 986

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

**PW EAGLE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. BUSINESS DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES**

*The Company*

PW Eagle, Inc., a Minnesota corporation, (the Company or PW Eagle) manufactures and distributes polyvinyl chloride (PVC) pipe and fittings used for potable water and sewage transmission, turf and agricultural irrigation, water wells, fiber optic lines, electronic and telephone lines, and commercial and industrial plumbing. The Company distributes its products throughout the United States, including Hawaii and Alaska, and a minimal amount of shipments to selected foreign countries. The Company's wholly-owned subsidiary, USPoly Company, LLC, (USPoly) manufactures and distributes polyethylene (PE) pipe and tubing products and accessories.

*Principles of Consolidation*—The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany transactions and amounts have been eliminated in consolidation.

*Cash Equivalents*—The Company considers all highly liquid temporary investments with an original maturity of three months or less when purchased to be cash equivalents.

*Accounts Receivable and Allowance for Doubtful Accounts*—Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The Company maintains an allowance for doubtful accounts sufficient to absorb future losses due to accounts that are potentially uncollectible. The allowance is based on our historical experience, prior years' write-offs, aging of past due accounts, financial condition of the customer and the general economic conditions of our market place. Actual results could differ from these estimates resulting in an increase to the allowance for doubtful accounts and bad debt expense.

*Inventories*—Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method and includes materials, labor and manufacturing overhead. The Company's principal raw material used in production is resin, which is subject to significant market price fluctuations.

*Property and Equipment*—Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization of property and equipment are computed on the straight-line method over estimated useful asset lives (shorter of asset life or lease term for leasehold improvements). Useful lives range from 10 to 30 years for buildings and improvements and 3 to 8 years for equipment and fixtures. Maintenance and repairs are charged to operations as incurred. Major renewals and betterments are capitalized. Fully depreciated assets are retained in property and accumulated depreciation accounts until removed from service. Upon disposal, assets and related accumulated depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to operations. The carrying value of property and equipment is evaluated for impairment based on historical and projected undiscounted cash flows whenever events or circumstances indicate that the carrying value may not be recoverable.

*Deferred Financing Costs*—Deferred financing costs are amortized over the term of the related indebtedness, unless extinguished or modified, using the effective interest method.

*Assets Held for Sale*—Assets held for sale are stated at the lower of cost or net realizable value and are classified as other non-current assets in the balance sheet. In conjunction with the development of the West Jordan, Utah, manufacturing facility, the Company was required to purchase and develop land for an entire industrial park. This land is currently held for sale.

*Goodwill*—Goodwill has been recorded for the excess of the purchase price over the fair value of net assets acquired in business combinations under the purchase method of accounting. Goodwill is not subject to periodic amortization, and is tested for impairment on an annual basis. If an event or circumstances change that would indicate the carrying amount may be impaired, goodwill will be tested for impairment on an interim basis. Impairment testing for goodwill is performed at the reporting unit level. Currently, the Company has determined it has two reporting units, PVC and PE. An impairment loss would generally be recognized when the carrying amount of the reporting units net assets exceeds the estimated fair value of the reporting unit.

The estimated fair value of the reporting unit is determined using discounted cash flow analysis. The Company completed its annual goodwill impairment test in the third quarter of 2006, with no changes in the carrying value of goodwill.

*Intangible Assets*—Intangible assets are being amortized against income using the straight-line method over their estimated useful lives, ranging from four to twelve years. The straight-line method of amortization reflects an appropriate allocation of

the costs of the intangible assets to earnings in proportion to the amount of economic benefits obtained by the Company in each reporting period. The Company periodically reviews intangible assets for impairment and assesses whether significant events or changes in business circumstances indicate that the carrying value of the assets may not be fully recoverable. Recoverability is assessed by comparing anticipated undiscounted future cash flows from operations to net book value.

*Fair Value of Financial Instruments*—Management estimates that the carrying value of its short and long-term debt approximates fair value. The estimated fair value amounts have been determined through the use of discounted cash flow analysis using interest rates currently available to the Company for issuance of debt with similar terms and remaining maturities. All other financial instruments, including accounts receivable, accounts payable and accrued liabilities, approximate fair value because of the short-term nature of these instruments. The Company recognizes all derivative financial instruments at fair value as either assets or liabilities.

*Revenue Recognition*—Revenue is recognized when product has been shipped, risk of loss has passed to the purchaser and we have fulfilled all of our obligations. We provide for as a reduction of revenue sales discounts, customer rebates and allowances in the period the related revenue is recognized, based on historical experience and the terms and conditions of sales incentive agreements. Customer rebates are accrued in accordance with EITF No. 01-9 “Accounting for Consideration Given by a Vendor to a Customer” and recorded as a reduction to sales.

*Product Warranty*—The Company’s products are generally under warranty against defects in material and workmanship for a period of one year. The Company has established a warranty accrual for its estimated future warranty costs using historical information on the frequency and average cost of warranty claims.

*Income Taxes*—Deferred income tax assets and liabilities are determined based on the differences between the financial statement and tax basis of assets and liabilities using currently enacted tax rates in effect for the years in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

*Earnings Per Share*—Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding and dilutive shares relating to stock options, warrants and restricted stock.

*Comprehensive Income (Loss)*—Components of comprehensive income (loss) for the Company include net income, changes in fair market value of the financial instrument designated as a hedge of interest rate exposure and changes in the fair market value of securities in the non-qualified deferred compensation plan. These amounts are presented in the Consolidated Statement of Stockholders’ Equity and Comprehensive Income.

*Use of Estimates*—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Issuance of Subsidiary Stock*—Adjustments to our investment in subsidiary related to a change in our ownership interest resulting from the issuance of stock by USPoly are recorded as an increase to additional paid in capital with a corresponding increase to the investment in USPoly.

*Share-based compensation*—In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS 123(R), “Share-Based Payment (as amended).” SFAS No. 123(R) eliminates the alternative to use the intrinsic value method of accounting that was provided in SFAS No. 123, which generally resulted in no compensation expense recorded in the financial statements related to the issuance of equity awards to employees and directors. SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS No. 123(R) establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all companies to apply a fair-value-based measurement method in accounting generally for all share-based payment transactions with employees. In accordance with the new rule, the Company adopted SFAS No. 123(R) using a modified prospective method for the recognition of share-based compensation expense on January 1, 2006.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards.” The Company has elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to FAS 123 (R). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-

in capital pool (APIC pool) related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of FAS 123(R).

Under FAS 123(R), share-based compensation cost is measured at the grant date, based on the estimated fair value of the award and is recognized as expense over the stated vesting period. The Company continues to use the Black-Scholes option-pricing model as its method for valuing stock options. The key assumptions for this valuation method include the expected term of the option, stock price volatility, risk-free interest rate, dividend yield, exercise price and forfeiture rate. Many of these assumptions are judgmental and highly sensitive in the determination of compensation expense.

### ***Recently Issued Accounting Standards***

#### *SFAS No. 158*

In September 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans,” which requires employers to recognize on their balance sheets the funded status of pension and other postretirement benefit plans, effective December 31, 2006 for calendar year-end companies. In addition SFAS No. 158 requires fiscal year-end measurement of plan assets and benefit obligations, eliminating the use of earlier measurement dates currently permissible, effective for fiscal years ending after December 15, 2008. We do not have any defined benefit pension or other postretirement plans and, accordingly, the adoption of the provisions of SFAS No. 158 did not have any effect on our financial position or results of operations.

#### *SFAS No. 157*

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements,” which establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair-value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. While we are still analyzing the effects of applying SFAS No. 157, we believe that the adoption of SFAS No. 157 will not have a material effect on our financial position or results of operations.

#### *Staff Accounting Bulletin No. 108*

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (“SAB”) No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements,” which addresses how the effects of prior-year uncorrected misstatements should be considered when quantifying misstatements in current-year financial statements. SAB No. 108 requires companies to quantify misstatements using both the balance sheet and income statement approaches and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The implementation of SAB No. 108 did not have any effect on our financial position or results of operations.

#### *FASB Staff Position No. AUG AIR-1*

In September 2006, the FASB issued Staff Position No. AUG AIR-1, “Accounting for Planned Major Maintenance Activities,” which prohibits accruing for the future cost of periodic major overhauls and planned maintenance of plant and equipment in annual and interim periods. This Staff Position is effective for fiscal years beginning after December 15, 2006 and must be retrospectively applied. We do not accrue for such costs in annual or interim periods and, accordingly, the adoption of this Staff Position will not have any effect on our financial position or results of operations.

#### *FASB Interpretation No. 48*

In July 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48 (FIN 48), “Accounting for Uncertainty in Income Taxes,” which defines the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority. FIN No. 48 applies to all tax positions accounted for under SFAS No. 109, “Accounting for Income Taxes.” FIN No. 48 is effective as of the beginning of the first fiscal year beginning after December 15, 2006. Upon adoption, the Company will adjust the financial statements if needed to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any adjustment will be recorded directly to our beginning retained earnings balance in the period of adoption and reported as a change in accounting principle. The Company is currently analyzing the effects of adopting Interpretation No. 48.

## 2. ACQUISITIONS & DIVESTITURES

### *US Poly Investment in and Sale of W.L. Plastics Corporation*

On October 1, 2003, USPoly, together with an affiliate of William Blair Mezzanine Capital Partners and members of W.L. Plastics' management team acquired the business of W.L. Plastics, LLC, for approximately \$17.6 million. PW Eagle acquired an equity interest in W.L. Plastics Corporation (W.L. Plastics) of approximately 5.4% in exchange for \$0.3 million in professional services rendered. PW Eagle contributed its equity interest to USPoly. At the time of the initial investment USPoly did not control W.L. Plastics, nor did they have the ability to exhibit significant influence over the management of W.L. Plastics. As such, USPoly initially accounted for this investment on the cost method. On January 16, 2004, USPoly invested an additional \$1.6 million in W.L. Plastics to increase its ownership percentage to 23%. Following the increase in ownership to 23%, USPoly accounted for the investment on the equity method of accounting, and had recorded \$0.6 million, net of tax of \$0.4 million, of equity in earnings of unconsolidated affiliate during 2004. Effective December 1, 2004, USPoly determined, in accordance with FIN 35, "Criteria for Applying the Equity Method of Accounting for Investments in Common Stock", that their investment in W.L. Plastics should be accounted for using the cost method of accounting as a result of the acquisition of UAC described further below, relinquishing their Board position and other changes.

On November 1, 2005, USPoly sold its interest in W.L. Plastics. USPoly received \$23.5 million cash and an additional \$1.2 million will be held in escrow for a period of 18 months (which is still outstanding at December 31, 2006) and is subject to customary post-closing contingencies. The gain realized in 2005 was \$18.4 million. The purchase price was subject to a working capital adjustment which was resolved in 2006, resulting in an additional gain of \$0.5 million. A substantial portion of the cash was used to pay down debt obligations of USPoly and PW Eagle.

### *Acquisition of Uponor Aldyl Company*

On September 27, 2004, USPoly acquired the business of Uponor Aldyl Company, Inc. (UAC) from Uponor Corporation, a Finnish company (the UAC Acquisition). UAC was a leading extruder of PE piping systems for natural gas with annual sales of \$41 million in 2003. The business had facilities in Tulsa and Shawnee, Oklahoma. UAC's business operations were combined with those of USPoly and the combined organization was re-named USPoly Company (USPoly).

The final purchase price for UAC was \$18.6 million (including direct transaction costs of \$1.0 million), composed of \$13.9 million of cash, \$2.1 million in the form of a note to Uponor Corporation, and \$2.6 million which was subsequently paid to Uponor Corporation on March 11, 2005. In addition, USPoly incurred \$0.6 million of deferred financing costs not included in the purchase price allocation below. Concurrent with this transaction, USPoly entered into a capital lease agreement for the Tulsa, Oklahoma manufacturing facility for \$1.5 million.

The UAC Acquisition has been accounted for as a purchase business combination. The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair values as follows (in millions):

Current assets	\$ 13.4
Property, plant and equipment	9.0
Intangible assets	2.5
Current liabilities	(6.3)
	<hr/>
	\$ 18.6
	<hr/>

Acquired intangible assets consist of technology and patents.

On June 30, 2005, USPoly sold the assets of its metals parts business for \$2.5 million, resulting in a gain on the sale of \$1.2 million. The metals parts business had net sales of approximately \$6 million in 2004.

Proforma information has not been included due to the immaterial value of the UAC Acquisition in relation to the consolidated results of operations of PW Eagle.

### *Sale of Facilities*

On August 18, 2006, the Company sold the Shawnee, Oklahoma facility for \$0.9 million net proceeds. A write-down to fair value of \$0.7 million had been previously recorded.

On April 1, 2004, the Company sold two manufacturing facilities in Baker City, Oregon and Hastings, Nebraska for an aggregate loss of \$0.4 million. Net proceeds of \$1.9 million were used to pay down the Company's Revolving Credit Facility. Prior to the sale of these facilities, PW Eagle was leasing these facilities to USPoly. After the sale of these facilities, USPoly entered into a capital lease with an independent third party for these same facilities (See Note 5).

### *Acquisition of Minority Interest in USPoly*

On October 18, 2005, PW Eagle completed a transaction whereby it acquired all of the shares of USPoly that it did not previously own. USPoly Company was merged into a wholly-owned subsidiary of PW Eagle and the new company is known as USPoly Company, LLC. PW Eagle paid a total of \$3.2 million cash and issued 351,904 shares of common stock to the holders of the minority shares in USPoly in consideration for their shares.

In connection with the merger, USPoly agreed with its subordinated lender that also held warrants to purchase shares in USPoly, to exchange the lender's rights under those warrants for a \$1.9 million note payable to the lender. The note bears interest at 12% and matures September 2009. The warrants had a put feature and were reflected as a liability on USPoly's financial statements. This note was fully paid in 2005. In addition, former USPoly holders of 599,392 common stock options were issued 111,810 PW Eagle common stock options. This was based on a ratio of 0.1889 shares of PW Eagle for each option to purchase one share of USPoly common stock.

### **3. OTHER FINANCIAL STATEMENT DATA**

The following provides additional information concerning selected balance sheet accounts (in thousands):

	<u>2006</u>	<u>2005</u>
Accounts receivable		
Trade receivables	\$ 62,002	\$ 89,123
Sales discounts and allowances	(1,665)	(2,061)
	<u>\$ 60,337</u>	<u>\$ 87,062</u>
Inventories		
Raw materials	\$ 13,308	\$ 14,083
Finished goods	55,682	50,156
	<u>\$ 68,990</u>	<u>\$ 64,239</u>
Property and equipment		
Land	\$ 8,152	\$ 8,225
Buildings and leasehold improvements	19,677	20,889
Machinery and equipment	117,512	112,999
Furniture and fixtures	3,481	3,240
Equipment components	5,743	5,312
Construction-in-progress	4,717	2,574

	159,282	153,239
Accumulated depreciation/amortization	(106,656)	(96,938)
	<u>\$ 52,626</u>	<u>\$ 56,301</u>

Included in land, buildings and leasehold improvements above are land and buildings currently held under a capital lease with a cost of \$23.0 million and accumulated amortization of \$5.8 million and \$5.1 million at December 31, 2006 and 2005, respectively.

Other assets

Deferred financing costs, net of accumulated amortization of \$976 and \$640, respectively	\$ 1,696	\$ 2,032
Assets held for sale	1,447	1,447
Other	2,412	1,675
	<u>\$ 5,555</u>	<u>\$ 5,154</u>

Accrued liabilities

Income taxes payable	\$ —	\$ 21,988
Accrued customer incentives	6,991	7,985
Accrued payroll and benefits	10,345	12,702
Accrued interest	29	86
Accrued royalty	2,637	2,954
Self insurance accruals	749	1,178
Dividends payable	897	840
Other	1,017	174
	<u>\$ 22,665</u>	<u>\$ 47,907</u>

The components of accumulated other comprehensive income are as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Change in fair value of financial instrument designated as a hedge of interest rate exposure, net of taxes	\$ —	\$ —	\$ (58)
Unrealized gain on securities from non-qualified deferred compensation plans	387	372	503
Total accumulated other comprehensive income	<u>\$ 387</u>	<u>\$ 372</u>	<u>\$ 445</u>

The following provide supplemental disclosures of cash flow activity (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Interest paid	\$ 3,312	\$ 17,301	\$ 13,977
Income taxes paid, net	53,324	1,346	21
Significant non-cash operating, investing and financing activities:			
Issuance of warrants	—	—	1,724
Cancellation of restricted stock	—	—	(397)
USPoly capital lease transaction	—	—	1,500
Issuance of a note to Uponor Corporation	—	—	2,125
Issuance of shares for non cash warrants exercised	2,890	11,681	—
Issuance of shares to USPoly shareholders	—	2,855	—

#### 4. GOODWILL AND INTANGIBLE ASSETS

The Company completed its most recent annual test for impairment of goodwill in the third quarter of fiscal 2006, with no change in the carrying value of goodwill recorded. As of December 31, 2006, there have been no events or circumstances that would indicate an impairment of the Company's goodwill and intangible assets exists.

The Company acquired intangible assets from business acquisitions consisting of customer relationships, manufacturing technology, patents and trademarks. Intangible assets have an initial weighted average life of eight years. The following table sets forth information relating to the amortization of these intangible assets (in thousands):

	<u>2006</u>	<u>2005</u>
Intangible Assets		
Customer relationships	\$ 1,331	\$ 1,331
Patents and trademarks	526	526
Manufacturing technologies	4,448	4,448
	<u>6,305</u>	<u>6,305</u>
Accumulated amortization	(3,241)	(2,285)
	<u>\$ 3,064</u>	<u>\$ 4,020</u>
Annual amortization expense	\$ 956	\$ 955
Estimated annual amortization expense		
2007	\$ 567	
2008	382	
2009	360	
2010	360	
2011	360	
Thereafter	<u>1,035</u>	

\$ 3,064

## 5. FINANCING ARRANGEMENTS

Current and long-term obligations at December 31, 2006 and 2005 consisted of the following (in thousands):

	2006	2005
Borrowings under revolving credit facilities		
PW Eagle	\$ —	\$ 7,184
USPoly	—	—
Total borrowings under revolving credit facilities	\$ —	\$ 7,184
Long-term debt, net of discounts		
PW Eagle Capital Lease Obligation	\$ 16,211	\$ 16,353
USPoly Capital Lease Obligations	3,315	3,354
Total current and long-term obligations	19,526	19,707
Less current maturities	(224)	(182)
Total long-term obligations	\$ 19,302	\$ 19,525

Our financing arrangements are described separately below.

### PW Eagle

On October 25, 2004, PW Eagle completed a refinancing of its debt. In connection with the refinancing, PW Eagle entered into a new \$100 million Revolving Credit Facility with Bank of America (formerly Fleet Capital Corporation), the CIT Group/Business Credit, Inc. and Wells Fargo Business Credit, Inc. (the "Agreement"). PW Eagle's borrowing capacity under the Agreement is limited to the sum of a Current Asset Collateral Component (CACC) based on percentages of accounts receivable and inventories and a Fixed Asset Collateral Component (FACC) of \$22 million. The FACC is reduced by \$0.8 million quarterly beginning March 31, 2005. Borrowings under the FACC bear interest at LIBOR plus 2.25% and borrowings under the CACC bear interest at LIBOR plus 2.0%. PW Eagle is required to pay a fee equal to 0.5% per annum of the unused portion of the Revolving Credit Facility.

This Agreement was amended in April 2006, to include both PW Eagle and USPoly as co-borrowers, and to reduce the interest rates and the unused line fee. Interest rates on borrowings under the amended Agreement are currently at LIBOR plus 1%. At future measurement dates, and based upon a defined fixed charge coverage ratio, the interest rates range from LIBOR plus 1% to LIBOR plus 1.75%. At December 31, 2006 the LIBOR rate was 5.375%.

Under the amended Agreement, the Company is required to comply with a minimum fixed charge coverage ratio, as well as other customary covenants, representations, warranties and funding conditions. Borrowings under the Agreement are collateralized by substantially all of the Company's assets. The amended Agreement expires on April 26, 2011.

In connection with the refinancing, PW Eagle issued \$16 million of Senior Subordinated Notes and \$8 million of Junior Subordinated Notes together with detachable warrants to purchase 366,651 shares of PW Eagle common stock (the "Subordinated Notes"). The Subordinated Notes were due on October 25, 2010, and were collateralized by substantially all assets of PW Eagle, subordinated to the security interest granted under the Revolving Credit Facility. The Senior Subordinated Notes bear interest at 19%, of which 13% was payable in cash monthly and 6% was deferred until October 31, 2009. The Junior Subordinated Notes bear interest at 22.5%, of which 13% was payable in cash monthly and 9.5% was deferred until October 31, 2009.

A debt discount of \$1.2 million was recorded upon the issuance of the Subordinated Notes based on the collective estimated fair value of the Subordinated Notes and warrants on the date issued. The discount is being amortized as a yield adjustment over the term of the Subordinated Notes using the effective interest method. The warrants contain provisions granting the warrant holder rights to require the Company to repurchase the warrants at the earlier of repayment or maturity of the Subordinated Notes or an event of default under the Subordinated Notes. In accordance with EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", the warrants have been recorded as a liability on the Company's balance sheet for \$1.5 million at December 31, 2004. During 2005 and 2004, the Company's value for the warrants increased due to an increase in the Company's stock price. Accordingly, the warrant liability was increased to fair value, resulting in a \$4.3 million and a \$0.2 million non-cash charge to interest expense in 2005 and 2004, respectively.

In connection with the refinancing, PW Eagle incurred financing costs of \$2.2 million, which have been capitalized and are being amortized over the life of the related debt as a component of interest expense.

In connection with the refinancing, PW Eagle repaid all amounts outstanding under the PWPipe and ETI Revolving Credit Facilities, the PWPipe and ETI Senior Term Notes and the PWPipe Senior Subordinated Notes (at the completion of this refinancing, ETI was legally merged into PW Eagle). At the date these obligations were repaid, PW Eagle had unamortized deferred financing costs related to the extinguished debt of \$2.0 million and unamortized debt discount of \$2.9 million on the PWPipe Senior Subordinated Notes. The terms of the PWPipe Senior Subordinated Notes also required a prepayment penalty of \$0.4 million. A charge of \$5.3 million related to these items was recorded in the fourth quarter of 2004 as a component of interest expense. Amortization of the deferred financing costs during 2004, prior to refinancing, was \$1.4 million.

In December 2005, PW Eagle repaid all amounts outstanding under the Senior Subordinated Notes and Junior Subordinated Notes. At the date these obligations were repaid, PW Eagle had unamortized deferred financing costs of \$1.0 million and unamortized debt discount of \$1.0 million on the Subordinated Notes. The terms of the Subordinated Notes also required a prepayment penalty of \$4.4 million. A charge of \$6.4 million related to these items was recorded in the fourth quarter of 2005 as a component of interest expense.

On March 26, 2004, PW Eagle entered into a sale-leaseback transaction on two manufacturing facilities in Sunnyside, Washington and Visalia, California. As a result of the sale-leaseback transaction, a financing lease obligation of \$3.6 million, net of the debt discount of \$0.1 million, was recorded based on the estimated fair value of the financing lease obligation. No gain or loss was recognized on the transaction. The financing lease obligation requires an annual lease payment of \$0.4 million, including interest at a rate of 9.7%. The financing lease has an initial term of twenty years, upon which the lease will automatically renew for ten years. The financing lease will continue to automatically renew every ten years until the financing lease is terminated. The financing lease includes certain financial covenants and requires the Company maintain an irrevocable letter of credit equal to \$0.4 million, which can be drawn in the event of a default under the lease. In connection with this transaction, warrants were issued to the lender to purchase 15,000 shares of common stock in PW Eagle, Inc. for \$0.01 a share at any time through March 26, 2009. The lender exercised these warrants during the second quarter of 2004. A debt discount totaling \$0.1 million has been recorded with the issuance of the warrant and is being amortized using the effective interest method as a yield adjustment over the initial term of the lease.

The Company entered into a sale-leaseback transaction agreement on February 28, 2002 for certain manufacturing facilities and the Eugene office building. As a result of the sale-leaseback transaction, a capital lease obligation of \$13.6 million, net of a debt discount of \$0.4 million, was recorded based on the collective estimated fair value of the capital lease obligation and warrant on the date issued. No gain or loss was recognized on the transaction. The capital lease obligation, which expires in September 2022, requires an annual lease payment of \$1.7 million, including interest at a rate of 11.46%. The capital lease includes certain financial covenants and requires the Company maintain an irrevocable letter of credit equal to one year's lease payments. The Company has a purchase option at the end of the lease term at an amount equal to the greater of the fair market value of the leased assets or \$14.7 million. If the purchase option is not exercised and the Company does not terminate the lease, the lease will automatically renew for a term of 10 years. In connection with this transaction, a warrant was issued to purchase 120,000 shares of Company common stock for \$0.01 a share at any time through February 28, 2022. A debt discount totaling \$0.4 million has been recorded with the issuance of the warrant. The discount is being amortized using the effective interest method as a yield adjustment over the term of the lease. The unamortized discount relating to the financing lease obligation was \$0.3 million at December 31, 2006 and 2005, respectively.

## **USPoly**

On September 27, 2004, USPoly acquired UAC (see Note 2). To finance this acquisition, USPoly obtained a new Senior Credit Facility. Under the new Senior Credit Facility, USPoly had a \$10 million revolving credit facility and term loans

amounting to \$6.9 million. The term loans are payable in monthly installments of \$0.1 million with interest at the prime rate plus 0.75% to 1.00%. The revolving credit facility bears interest at prime plus 0.5%, and a non-use fee of 0.5%. The prime rate was 5.25% at December 31, 2004. These new senior loans are due September 30, 2007 and are collateralized by substantially all of USPoly's assets. In connection with the refinancing, USPoly incurred financing costs of \$0.6 million which were capitalized and are being amortized over the life of the debt. USPoly also entered into a capital lease agreement for the Tulsa, Oklahoma manufacturing facility connected with the acquisition of UAC for \$1.5 million. The capital lease includes a put feature. Under the put feature if the lessor meets certain requirements, USPoly would be obligated to purchase the Tulsa plant for \$1.5 million or the current market value, whichever is greater.

On January 16, 2004, USPoly entered into a Subordinated Debt Agreement with Medallion Capital, Inc. (Medallion) for \$1.3 million. Interest of 12% on the Subordinated Debt is due monthly and the note matures on January 15, 2009. In connection with the Subordinated Debt Agreement, warrants were issued to purchase up to 7.5% of USPoly's then outstanding common stock on a fully diluted basis for \$10 per issuance (fixed warrants). In addition, warrants were issued for the purchase of the lesser of 14% of USPoly's then outstanding common stock on a fully diluted basis or for an amount sufficient to incrementally provide Medallion an overall 24.5% internal rate of return on the subordinated debt (performance warrants). The fixed warrants are exercisable at any time after January 15, 2004 through the fifth anniversary of the date when all outstanding principal and accrued interest on the subordinated debt has been paid in full. The performance warrants are exercisable immediately through the later of the maturity of the subordinated debt or at which time the subordinated debt and interest are paid in full. The warrants also contain a clause whereby after the occurrence of a put date, defined as the earlier of the maturity of the subordinated debt or an occurrence of a default under the debt agreement until the expiration date, the lender shall have the right to sell to USPoly all or a portion of the warrants or the warrant based shares. Under the clause, USPoly would be obligated to purchase such warrant or warrant based shares at USPoly's fair value. The warrants are therefore recorded as a liability, \$1.2 million at December 31, 2004 which will be periodically adjusted to fair value. A debt discount totaling \$0.4 million, representing the initial value of the warrants, has been recorded in connection with the issuance of the warrants and is being amortized using the effective interest method as a yield adjustment over the term of the debt. During 2005 and 2004, the Company increased its estimate of the value of USPoly, based on its operating performance, the UAC Acquisition (see Note 2), and the sale of W.L. Plastics (see Note 2). Accordingly, the warrant liability was adjusted to fair value, resulting in a \$0.7 million and a \$0.8 million non-cash charge to interest expense in 2005 and 2004, respectively.

In connection with the UAC Acquisition, USPoly amended its Subordinated Debt Agreement with Medallion to provide an additional \$3.7 million of borrowings, bringing the total amount of the Subordinated Debt facility to \$5.0 million. The \$3.7 million note bears interest at 12% payable monthly and requires principal payments of \$65,315 monthly beginning October 1, 2007, through September 1, 2009, with all remaining principal payable on September 17, 2009.

During the fourth quarter of 2005, USPoly repaid all amounts outstanding under the Senior Credit Facility and the Subordinated Debt Agreement. At the date these obligations were repaid, USPoly had unamortized deferred financing costs of \$0.5 million and unamortized debt discount of \$0.2 million. The terms of the loan agreements also required prepayment penalties of \$0.4 million. A charge of \$1.1 million related to these items was recorded in the fourth quarter of 2005 as a component of interest expense.

On April 1, 2004, USPoly entered into lease transactions on manufacturing facilities in Hastings, Nebraska and a distribution center in Baker City, Oregon. These leases are recorded as capital leases, with a total financing lease obligation of \$1.9 million. The leases require monthly payments of \$20,000, including interest at a rate of 11.25%. These financing leases have a term of twenty years, with purchase options of the greater of \$2 million (\$1.3 million on the Hastings property and \$0.7 million on the Baker City property) or the fair market value at the end of the lease term. As a part of these transactions, USPoly issued standby letters of credit for \$0.2 million, which can be drawn in the event of default under the leases.

Scheduled aggregate annual maturities of amounts classified as debt obligations at December 31, 2006, under terms of the capital lease obligations are (in thousands):

	<u>Capital Lease Obligations</u>
2007	\$ 2,633
2008	2,633
2009	2,633

2010	2,618
2011	2,618
Thereafter	29,263
Total scheduled cash payments	42,398
Less amounts representing interest	22,872
Total current and non current maturities	19,526
Less current maturities	(224)
Total amount classified as debt obligations at December 31, 2006	\$ 19,302

Management estimates that the fair value of borrowing under its debt agreements approximates the carrying value at December 31, 2006, as the applicable interest rates approximate current market rates.

As described above, under current financing agreements, the Company is required to comply with certain restrictive financial ratios and covenants. At December 31, 2006, the Company was in compliance with all debt covenants.

## 6. GUARANTEES

*Product warranties:* The Company's products are generally guaranteed against defects in material and workmanship for one year. The product warranty liability is reviewed regularly by management to insure the Company's warranty allowance is adequate based on frequency and average cost of historical warranty claims activity. Management studies trends of warranty claim activity to improve pipe quality and pipe installation techniques to minimize future claims activity.

(In thousands)

	2006	2005
Accrual for product warranties – beginning of year	\$ 325	\$ 325
Accruals for warranties issued during the year	565	305
Settlements made during the year	(615)	(305)
Accrual for product warranties – end of year	\$ 275	\$ 325

*Standby letters of credit:* The Company is required to maintain standby letters of credit totaling \$3.1 million. These letters of credit guarantee payment to third parties in the event the Company is unable to pay in a timely manner. Standby letters of credit reduce the funds available under the revolving credit facilities by \$3.1 million. No amounts were drawn on these letters of credit as of December 31, 2006.

## 7. DERIVATIVE INSTRUMENTS

The Company follows Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted (FAS 133). FAS 133 requires that all derivative instruments, such as interest rate swap contracts, be recognized in the financial statements and measured at their fair market value.

In the normal course of business, the Company is exposed to changes in interest rates. The Company has established policies and procedures that govern the management of these exposures through the use of financial instruments. The Company's objective in managing its exposure to interest rates is to decrease the volatility that changes in interest rates might have on earnings and cash flows. To achieve this objective, the Company uses fixed rate agreements to adjust a portion, as determined by management and terms of the underlying debt agreements, of total debt that is subject to variable interest rates. Under the fixed rate agreements, the Company pays a variable rate of interest and receives a fixed rate of interest. These derivative instruments are considered to be a hedge against changes in the amount of future cash flows associated with the Company's interest payments related to a portion of its variable rate debt obligations. Accordingly, the Company designates these

instruments as cash flow hedges. The derivative instruments are reflected at fair value, net of the underlying debt, in the Company's balance sheet, and the related gains or losses on this contract are deferred in shareholders' equity as a component of comprehensive income.

Effective April 1, 2003, the Company entered into a fixed rate swap agreement for 50% of its ETI Senior Term Note. This Senior Term Note was paid in connection with the new PW Eagle Senior Credit Facility of October 25, 2004. On November 12, 2004, the Company entered into a fixed rate swap agreement for 50% of the fixed asset collateral portion of the new Senior Credit Facility amounting to \$11 million. This total notional amount was comprised of the remaining ETI swap contract amounting to \$1.7 million, and a new PW Eagle swap contract amount of \$9.3 million. The total notional amount decreases in proportion to reductions in the fixed asset collateral portion of the credit facility, until the fixed rate agreement terminates in November of 2007. During the fourth quarter of 2005, this fixed asset collateral portion of the credit facility was entirely paid, and the related swap contracts were terminated. At December 31, 2005 and 2006 the Company had no outstanding swap contracts.

## 8. COMMITMENTS AND CONTINGENCIES

### *Litigation*

The Company is subject to various legal proceedings and claims that have arisen in the ordinary course of its business and have not been finally adjudicated. In management's opinion, the disposition of present proceedings and claims will not have a material adverse effect on the Company's financial position, results of operations or cash flows in future periods.

### *Operating Leases*

The Company has non-cancelable operating leases for certain operating facilities that expire in 2011.

Future minimum lease payments at December 31, 2006, are (in thousands):

2007	\$ 943
2008	752
2009	719
2010	400
2011	2
	<hr/>
	\$ 2,816
	<hr/>

Rent expense under all operating leases was \$1.4 million, \$1.4 million and \$1.3 million for the years ended December 31, 2006, 2005 and 2004, respectively.

## 9. COMMON STOCK PURCHASE WARRANTS

In connection with various financing arrangements, the Company has issued warrants to purchase common stock and Class B common stock as described below. In addition, multiple warrants have been exercised, also described below.

During December 2006, a cash conversion of warrants to purchase 35,000 shares of common stock was completed for \$945,000.

During August 2006, a cash conversion of warrants to purchase 50,000 shares of common stock was completed for \$1,350,000.

During May 2006, a cash conversion of warrants to purchase 39,500 shares of common stock was completed for \$742,620.

On February 8, 2006, Mass Mutual completed the cashless conversion of warrants to purchase 107,692 shares of the Company's common stock and was issued 59,322 shares of common stock in the transaction.

On January 5, 2006, JP Morgan Partners (23A SIBC), L.P. completed the cashless conversion of warrants to purchase 242,308 shares of common stock and was issued 135,681 shares of common stock in the transaction.

On January 5, 2006, Corporate Properties Associates 14 Incorporated completed the cashless conversion of warrants to purchase 125,818 shares of common stock and was issued 125,745 shares of common stock in the transaction.

In December 2005, as part of the private placement transaction described in Note 14, warrants were granted to investors to purchase 304,667 shares of common stock at \$27.00 per share expiring in December 2010. These warrants were valued at \$13.74 per share on the date of issuance. The total value of the warrants, \$4,682,076 was recorded as equity in warrants on the consolidated balance sheet.

On September 30, 2005, PW Eagle granted 12,000 warrants to a consultant at the price of \$0.01 per share with an expiration date of August 1, 2015. The difference between the exercise price and the fair value, amounting to \$0.1 million, was charged to expense.

On May 17, 2005, the holder of a warrant to purchase 1,343,452 shares of common stock at \$0.01 per share made a cashless exercise of the warrant and received 1,340,657 shares of common stock. The warrant holder also exercised its right to require the Company to file a Registration Statement on the Form S-3, to register these shares. The Registration Statement became effective August 12, 2005. As of October 4, 2005, all shares registered with this Registration Statement had been sold.

In 2004, holders of the Senior Subordinated Note received warrants to purchase a total of 366,651 shares of the Company's common stock at \$0.01 per share that expire October 25, 2010. These warrants contained a put feature that required the Company to repurchase the shares at the fair market value of the stock on the date the warrants could be put to the Company. These warrants were included in other long-term liabilities due to their put feature. The initial valuation of the warrants was for \$1.2 million and was recorded as a discount on the subordinated debt. This valuation was increased by \$0.3 million to \$1.5 million with an offsetting entry to interest expense due to the increase in value of the Company's stock from October 25, 2004 to December 31, 2004. The valuation of these warrants was increased by \$4.3 million to \$5.8 million with an offsetting entry to interest expense due to the increase in value of the Company's stock from January 1, 2005 to November 16, 2005. On November 16, 2005, the warrant holder elected to make a cashless exercise of their warrants to purchase 366,302 shares of common stock. The share differential represents the effect of the cashless exercise in which the holder forfeits the right to receive a certain number of warrant shares in lieu of paying the current exercise price in cash.

During 2004, the Company issued additional warrants to purchase 20,818 shares of the Company's stock in connection with certain lease agreements. These warrants were valued at \$0.1 million and were recorded as an increase to stockholder's equity and a discount on the capital lease obligation.

The former holders of the Senior Subordinated Notes held warrants to purchase a total of 1,940,542 shares of the Company's common stock or Class B common stock at \$0.01 per share which expire September 20, 2009. The number of shares issuable upon exercise and the warrant exercise price were adjustable in the event the Company paid a dividend in common stock, subdivided or combined its common stock, or sold capital stock or options to purchase capital stock at a price less than the market price of its capital stock on the date of issuance or completed a capital reorganization or reclassification of its capital stock. The Company granted the warrant holders a right of first refusal. The Company cannot sell or issue any of its common stock, options or convertible securities unless it has first offered to sell to each warrant holder its proportionate share. Certain affiliates of the Company granted the warrant holders tagalong rights that gave the warrant holders the right to join any affiliate in the sale of any of their shares. On January 28, 2005, some warrant holders elected to make a cashless exercise of their warrants to purchase 597,090 shares of Class B common stock in exchange for 595,508 shares of Class B common stock. The share differential represented the effect of the cashless exercise in which, in lieu of paying the current exercise price in cash, the holder forfeited the right to receive a certain number of warrant shares having a fair market value equal to the warrant exercise price. The Class B common stock issued to the warrant holders was convertible, at the holders' option, into shares of the Company's common stock at a 1:1 ratio. On December 20, 2005, the 595,508 shares of Class B common stock were converted to regular common stock under the 1:1 ratio.

## 10. INCOME TAXES

Deferred tax assets and liabilities represent temporary differences between the basis of assets and liabilities for financial reporting purposes and tax purposes. Deferred tax assets are primarily related to amounts, which have been deducted for financial statement purposes but have not been deducted for income tax purposes and the tax effect of net operating loss carryforwards.

At December 31, 2006, the Company had a net deferred tax asset of approximately \$5.0 million (approximately \$2.7 million at December 31, 2005). The net deferred tax asset represents management's best estimate of the tax benefits that will more likely than not be realized in future years at each reporting date.

Deferred taxes as of December 31, 2006 and 2005, are summarized as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Current deferred taxes:		
Inventory valuation allowance	\$ 1,054	\$ 64
Warranty reserves	105	117
Allowance for doubtful accounts	384	365
Accrued liabilities	1,277	1,435
Inventory cost capitalization	464	397
Other	—	4
	<u>\$ 3,284</u>	<u>\$ 2,382</u>
Long-term deferred taxes:		
Excess tax over book depreciation	\$ (1,121)	\$ (2,462)
Non-compete agreement	67	86
Federal and state net operating loss carryforwards	—	65
State tax credit carryforwards	—	110
Non-qualified stock options	603	—
Restricted stock options	11	328
Royalty agreement	1,690	2,355
Intangibles	(437)	(707)
Investment earnings in non-qualified plan	924	550
Other	8	—
	<u>\$ 1,745</u>	<u>\$ 325</u>

Income tax expense (benefit) for the years ended December 31 consists of the following (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current	\$ 38,663	\$ 21,263	\$ 136

Deferred	\$ (2,322)	\$ 11,652	\$ (3,195)
Income tax expense (benefit) from operations	36,341	32,915	(3,059)
Income tax expense for equity in earnings of unconsolidated affiliate	—	—	384
Total income tax expense (benefit)	\$ 36,341	\$ 32,915	\$ (2,675)

A reconciliation of the expected federal income taxes, using the effective statutory federal rate of 35%, with the provision (benefit) for income taxes is as follows (in thousands):

	2006	2005	2004
Expected federal expense (benefit)	\$ 33,963	\$ 28,032	\$ (2,852)
State taxes, net of federal benefit and credits	3,115	3,444	(361)
Permanent difference for interest charges related to stock warrants	—	1,992	584
Deduction for domestic production activities	(948)	(720)	—
Other	211	167	(46)
Income tax expense (benefit)	\$ 36,341	\$ 32,915	\$ (2,675)

## 11. EARNINGS PER COMMON SHARE

The following tables reflect the calculation of basic and diluted earnings per share:

(in thousands, except per share amounts)

	2006	2005	2004
Net income (loss)	\$ 60,695	\$ 46,950	\$ (5,540)
Weighted average shares – basic	11,930	8,888	7,096
Effect of stock options, warrants and restricted shares	166	1,206	—
Weighted average shares – diluted	12,096	10,094	7,096
Net income (loss) per share – basic	\$ 5.09	\$ 5.28	\$ (0.78)
Net income (loss) per share – diluted	\$ 5.02	\$ 4.65	\$ (0.78)

The following table summarizes outstanding securities which are excluded from the computation of diluted earnings per share because inclusion of these shares would be anti-dilutive (in thousands):

	2006	2005	2004
Stock options	—	184	807
Stock warrants	—	305	2,783
Unvested restricted stock	—	—	209

## 12. EMPLOYEE BENEFIT PLANS

*PW Eagle Employees' Savings 401(k) Plan*

PW Eagle's and USPoly's 401(k) plan covers all eligible employees. Eligible employees may elect to defer up to 25% of their eligible compensation. The plan provides for Company-paid matching contributions of 50% of participant contributions up to 6% of compensation. The match was temporarily suspended January 1, 2004 and reinstated July 1, 2004.

PW Eagle's board of directors determines each year if an additional contribution will be made based on PW Eagle's performance. An additional contribution of 3% was approved for 2006 and 2005. No additional contribution was approved for 2004. Total amounts charged to operations were \$2.0 million, \$1.9 million and \$0.3 million for the years ended December 31, 2006, 2005 and 2004, respectively.

USPoly participated in PW Eagle's retirement savings plan in 2006, and total contributions to the Plan were \$0.3 million.

On December 15, 2003, a separate plan with terms similar to PW Eagle's plan, USPoly Employees' Savings Plan, was created for employees of USPoly, and Company matching contributions to the plan were \$133,000 and \$43,000 for the years ended December 31, 2005 and 2004, respectively. No discretionary profit sharing contributions were made in 2005 or 2004.

All active hourly union employees in the Company's Buckhannon, West Virginia plant are covered by a defined contribution plan. The Company's sole responsibility is to make contributions, in accordance with the union contract, of \$95, \$85 and \$80 per month per employee in 2006, 2005 and 2004, respectively. Contributions by the Company in 2006, 2005 and 2004 totaled \$73,000, \$67,000 and \$66,000, respectively.

#### *PW Eagle Top Hat Plan*

The PW Eagle Deferred Top Hat Plan (the "Plan") allows for a select group of management, directors, or highly compensated employees to accumulate additional income and security for their retirement by contributing additional amounts above that permitted under the PW Eagle Employees' Savings 401(k) plan.

There is no statutory limitation on the amount eligible employees can defer under this Plan. The Plan allows for Company-paid matching contributions of 50% of participant contributions up to 6% of compensation. However, this amount will be offset by the Company-paid matching contributions made to the Company's 401(k) plan for each participant. Therefore, the maximum matching contribution paid by the Company on behalf of each participant for both PW Eagle's Employee Savings 401(k) plan and this Plan is 6% of compensation. Company matching contributions to the Plan were \$18,000, \$16,000 and \$2,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company may also make an additional annual supplemental contribution based on PW Eagle's performance. Supplemental contributions paid to this Plan for 2006 was \$21,000. There were no supplemental contributions paid to this Plan for 2005 or 2004.

The Plan also allows for a discretionary contribution by PW Eagle's board of directors. No discretionary contributions have been made to the Plan since the date of its inception.

PW Eagle holds the contributions made into this Plan in a rabbi trust. The assets held in the rabbi trust are subject to the claims of general creditors of PW Eagle. Therefore, the Company carries the balance in the rabbi trust in both the asset and liability sections of the Consolidated Balance Sheet. The amount included therein for 2006, 2005 and 2004 was \$2.4 million, \$1.7 million and \$1.3 million, respectively.

### **13. SHARE-BASED COMPENSATION**

(in thousands, except per share amounts)

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS 123(R), "Share-Based Payment (as amended)." SFAS No. 123(R) eliminates the alternative to use the intrinsic value method of accounting that was provided in SFAS No. 123, which generally resulted in no compensation expense recorded in the financial statements related to the issuance of equity awards to employees and directors. SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS No. 123(R) establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all companies to apply a fair-value-based measurement method in accounting generally for all share-based payment transactions with employees. In accordance with the new rule, the Company adopted SFAS No. 123(R) using a modified prospective method for the recognition of share-based compensation expense on January 1, 2006.

On November 10, 2005, the FASB issued FASB Staff Position SFAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." The Company has elected to adopt the alternative transition method provided in this FASB Staff Position for calculating the tax effects of share-based compensation pursuant to FAS 123(R). The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123(R).

Under SFAS 123(R), share-based compensation cost is measured at the grant date, based on the estimated fair value of the award and is recognized as expense over the stated vesting period. The Company continues to use the Black-Scholes option-pricing model as its method for valuing stock options. The key assumptions for this valuation method include the expected term of the option, stock price volatility, risk-free interest rate, dividend yield, exercise price and forfeiture rate. Many of these assumptions are judgmental and highly sensitive in the determination of compensation expense. The following is a discussion of our methodology for developing each of the assumptions used in the valuation model when share-based awards are granted:

*Term* - This is the period of time over which the options granted are expected to remain outstanding. Options granted have a maximum term of ten years.

*Volatility* – This is a measure of the amount by which a price has fluctuated or is expected to fluctuate. Volatilities are based on historical volatility of PW Eagle's shares and other factors, such as expected changes in volatility arising from planned changes in PW Eagle's business operations. An increase in the expected volatility will increase compensation expense.

*Risk-Free Interest Rate* – This is the U.S. Treasury rate for the date of the grant having a term equal to the expected term of the option. An increase in the risk-free interest rate will increase compensation expense.

*Dividend Yield* – With share based awards granted after January 1, 2006, we have incorporated a dividend yield. Prior to 2006, we did not make any dividend payments. An increase in the dividend yield will decrease compensation expense.

*Forfeiture Rate* – This is the estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. An increase in the forfeiture rate will decrease compensation expense. Based on historical forfeitures of share-based awards, the Company has estimated a 4% forfeiture rate. The Company will annually evaluate this assumption as future forfeitures occur.

The Company granted stock options during 2006 and 2005. The Company did not grant any stock options in 2004. The Black-Scholes options pricing model was used to determine fair value of each stock option grant on the date of grant. The following assumptions were used in computing the Black-Scholes value for each stock option granted in 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Expected volatility	80% - 95%	71% - 80%
Expected dividend yield	1.08%	--
Expected life (term)	7 years	7 years
Risk-free interest rate	4.8% - 5.0%	3.8% - 4.5%

The share-based compensation expense, related to all of the Company's share-based awards, recognized for 2006, in selling, general and administrative expense was comprised as follows (in thousands, except per share data):

	<u>2006</u>
Share-based compensation expense before taxes	\$ 3,426
Related income tax benefits	(996)
Share-based compensation expense, net of taxes	<u>\$ 2,430</u>
Net share-based compensation expense, per common share:	
Basic	\$ 0.20
Diluted	\$ 0.20

As of December 31, 2006, there was approximately \$2.0 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under our share-based compensation plan. This unrecognized compensation cost is expected to be recognized over the remaining vesting period through May 26, 2009.

Prior to adopting the provisions of SFAS 123(R), we applied Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for our share-based awards. The following table details the effect on net earnings and earnings per share had compensation expense for the employee-based awards been recorded during 2005 and 2004 based on the fair value method under SFAS 123.

	<u>2005</u>	<u>2004</u>
Net income (loss) applicable to common stock, as reported	\$ 46,950	\$ (5,540)
Add: Stock-based employee compensation expense included in reported net (loss) income, net of tax	128	250
Less: Stock-based employee compensation expense under fair value-based method, net of tax	(743)	(665)
Proforma net income (loss) applicable to common stock	<u>\$ 46,335</u>	<u>\$ (5,955)</u>
Basic earnings (loss) per common share		
As reported	\$ 5.28	\$ (0.78)
Pro forma	5.21	(0.84)
Diluted earnings (loss) per common share		

As reported	\$	4.65	\$	(0.78)
Pro forma		4.59		(0.84)

*Share-based Compensation Plan*

As of January 1, 2006, we have one active share-based compensation plan, described below.

The PW Eagle, Inc. 1997 Stock Option Plan (the "Plan") permits the granting of nonqualified and incentive stock options to purchase shares of common stock up to a total of 2,700,000 shares. The exercise price of an incentive or nonqualified stock option may not be less than 100% of the fair market value of the Company's common stock on the date of grant. These options generally vest over a period of time set by the Board of Directors.

The term of an incentive stock option may not exceed ten years from the date of grant. All employees of the Company or any subsidiary are eligible to receive incentive stock options. All employees, directors and officers of, and consultants and advisors to, the Company or any subsidiary are eligible to receive nonqualified stock options. The Board of Directors may terminate or amend the Plan but may not amend the Plan to materially increase the benefits accruing to any individual or materially modify the requirements for eligibility to participate in the Plan without the approval of the Company's shareholders. The shareholders approved an increase in the number of shares available for the granting of options under the Plan from 2,200,000 to 2,700,000 on May 26, 2006.

A summary of the status of the Company's stock options as of December 31, 2006, 2005 and 2004, and changes during the year ended on those dates is presented below (shares in thousands):

	2006		2005		2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,136	7.84	807	\$ 4.64	1,107	\$ 4.30
Granted	102	25.20	371	15.04	—	—
Exercised	(840)	5.39	(33)	10.06	(161)	2.13
Canceled	(34)	5.77	(9)	9.53	(139)	4.84
Outstanding at end of year	364	18.57	1,136	7.84	807	4.64
Options exercisable at year end	132	17.89	759	5.55	610	4.25
Options available for future grant	374		441		303	

The weighted average fair value of stock options granted in 2006 and 2005 was \$20.54 and \$10.53, respectively. No stock options were granted during 2004.

The total intrinsic value of outstanding and exercisable options at December 31, 2006 was \$5.8 million and \$2.2 million, respectively.

The total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 was \$18.5 million, \$.2 million and \$.2 million, respectively.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2006 (shares in thousands):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 4.04 to \$4.51	46	6.74	\$4.05	21	\$4.04
\$5.15 to \$5.82	69	6.54	5.28	22	5.27
\$16.00	4	3.45	16.00	4	16.00
\$23.47 - \$27.85	245	9.12	25.08	85	24.62
	364	8.27	\$18.57	132	\$ 17.89

#### *Restricted Stock Grants*

In April 2006, the Company awarded an employee a 2,500 share restricted stock grant. The intrinsic value for this grant is \$28.78 per share.

The Company did not award any restricted stock grants in 2005 or 2004. Restricted stock shares carry dividend and voting rights. Sales or transfers of these shares are restricted prior to the date of vesting. The restricted stock award granted in 2006 provides a 20% immediate vesting in 2006, an additional 30% vesting during 2007, with the remaining 50% to vest in 2008. Restricted stock is subject to forfeiture in the event of termination of employment prior to the vesting date for reasons other than death or disability. During May 2006, 144,078 shares of restricted stock vested immediately upon the election of the new Board of Directors on May 26, 2006. During 2006, 2005 and 2004, 168,998, 38,300 and 63,800 shares of restricted stock vested, respectively. A total of 2,000 and 79,300 shares of restricted stock were cancelled in 2006 and 2004, respectively, due to the departure of certain officers and employees. There were no cancellations of restricted stock shares during 2005. As of December 31, 2006, 2,000 shares of restricted stock were outstanding, of which all 2,000 are unvested.

Unearned compensation was charged for the fair value of the restricted shares at the time of award prior to the implementation of SFAS 123(R) on January 1, 2006. The unearned compensation is shown as a reduction of stockholders' equity in the consolidated balance sheet and was being amortized ratably as compensation expense over the related vesting period. Total amounts charged to operations were \$0.2 million and \$0.3 million for the years ended December 31, 2005 and 2004, respectively. Upon implementation of SFAS 123(R) on January 1, 2006, the Company accounts for noncash compensation related to restricted stock grants under the share-based compensation plan.

## **14. STOCKHOLDERS' EQUITY**

#### *Sale of Common Stock*

In December 2005, PW Eagle sold 1,018,667 shares of common stock at a price of \$18.75 per share and 304,667 warrants to purchase common stock at a price of \$27.00 per share. The net proceeds of \$17.9 million were used to pay down revolving debt.

#### *Share Repurchase Program*

On June 16, 2006, the Board of Directors authorized the Company to repurchase up to \$40 million of the Company's outstanding common stock. The share repurchase program has an expiration of June 30, 2008. Repurchases may be made in the open market and in privately negotiated transactions utilizing various hedge mechanisms, including, among other things, the sale to third parties of put options for the Company's common shares, or otherwise. To facilitate the repurchase of shares of its common stock under the Company's share repurchase program, the Company entered into a Rule 10b5-1 purchase plan on August 21, 2006 to purchase up to \$31.5 million of the total \$40 million approved by the Board of Directors. Through December 31, 2006, the Company repurchased 529,865 shares of PW Eagle, Inc. common stock in the open market for a total of approximately \$16.4 million under the rule 10b5-1 plan.

#### *Put Option Transactions*

The Company accounts for put option transactions on Company stock in accordance with Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", ("SFAS 150"). SFAS 150 requires put options to be measured at fair value and recognized on the balance sheet as liabilities.

As part of the share repurchase program, on August 15, 2006, the Company sold put options covering 200,000 shares of Company stock for \$441,000 in premiums. The put options had a strike price of \$29.85 per share. They expired on November 15, 2006 unexercised, therefore, the Company recognized the total \$441,000 as non-operating income during 2006.

#### Dividends

Cash dividends declared during 2006 were as follows (per share):

	<u>December 31, 2006</u>
First Quarter	\$ 0.075
Second Quarter	0.075
Third Quarter	0.075
Fourth Quarter	0.075
	<u>\$ 0.300</u>

## 15. RESTRUCTURING ACTIVITIES

In response to difficult economic conditions and poor operating results, the Company decided to consolidate the PWPipe and ETI business units under common management control in October 2003. The former ETI headquarters office in Denver, Colorado was closed and all administrative and accounting functions were transferred to the Eugene, Oregon office. In addition, effective January 2004, the corporate office in Minneapolis, Minnesota was closed and all corporate office functions were transferred to the Eugene, Oregon office, which now represents our corporate headquarters, expanding the previous role as our lead operating office. As a result of the consolidation, approximately 30 positions were eliminated. In addition, certain officers and directors resigned their positions and cancelled consulting agreements. In connection with the officer resignations, the Board of Directors modified certain outstanding restricted stock and stock option awards effective January 2, 2004. The modifications allow for continued vesting of the stock awards, which would have been forfeited upon the officers' resignation under the original terms, resulting in a charge of \$0.5 million. During 2004, the Board of Directors approved the payment of management bonuses of \$1.0 million for the successful restructuring of the Company. The recipients of the management bonus elected to receive \$0.8 million in PW Eagle common stock and \$0.2 million in cash.

In connection with these activities, the Company incurred restructuring charges of \$1.6 million in 2004. At December 31, 2005 and 2006, the Company has no payments remaining from the restructuring.

Following is a summary of the restructuring reserve activity (in thousands):

	<u>Severance</u>	<u>Other</u>	<u>Total</u>
Restructuring accrual at December 31, 2003	\$ 1,178	\$ —	\$ 1,178
Additions to reserve	106	41	147
Charges against reserve	(1,214)	(41)	(1,255)
Restructuring accrual at December 31, 2004	70	—	70
Charges against reserve	(70)	—	(70)
Restructuring accrual at December 31, 2005 and 2006	\$ —	\$ —	\$ —

## 16. SEGMENT INFORMATION

Segments of Business

The Company manufactures and distributes PVC and PE pipe and fittings used for potable water and sewage transmission, turf and agricultural irrigation, natural gas transmission, water wells, fiber optic lines, electronic and telephone lines, and commercial and industrial plumbing. The PE segment operates under the name USPoly. We distribute our products throughout the United States, including Hawaii and Alaska, with a minimal amount of shipments to certain foreign countries. While there are similarities in technology and manufacturing processes utilized between the segments, differences exist in products and customer base, with the PVC segment focused on the water, irrigation and electrical products and customers, and the PE segment focused primarily on the natural gas distribution products and customers.

A summary of the Company's business activities reported by its two business segments follows (in thousands):

<u>Business Segments (in thousands)</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net sales:			
PVC	\$ 631,901	\$ 612,258	\$ 445,880
PE	82,211	81,986	29,074
	<u>\$ 714,112</u>	<u>\$ 694,244</u>	<u>\$ 474,954</u>
Operating income:			
PVC	\$ 94,354	\$ 84,387	\$ 11,140
PE	5,585	4,394	138
Total operating income	<u>99,939</u>	<u>88,781</u>	<u>11,278</u>
Gain on sale of investee and non-operating income	897	18,363	—
Interest expense	<u>(3,800)</u>	<u>(27,051)</u>	<u>(20,668)</u>
Income (loss) before income taxes and minority interest	<u>\$ 97,036</u>	<u>\$ 80,093</u>	<u>\$ (9,390)</u>
Expenditures for property and equipment:			
PVC	\$ 6,316	\$ 3,145	\$ 1,582
PE	1,285	1,527	195
Total	<u>\$ 7,601</u>	<u>\$ 4,672</u>	<u>\$ 1,777</u>
Depreciation and amortization expense:			
PVC	\$ 8,735	\$ 9,987	\$ 10,381
PE	2,342	2,631	1,116
Total	<u>\$ 11,077</u>	<u>\$ 12,618</u>	<u>\$ 11,497</u>
Goodwill:			
PVC	\$ 3,651	\$ 3,651	\$ 3,651
PE	2,790	2,790	—

Total	\$	6,441	\$	6,441	\$	3,651
<hr/>						
Total Assets:						
PVC	\$	203,371	\$	191,788	\$	159,675
PE		34,174		39,961		36,742
Corporate		5,029		2,707		14,359
<hr/>						
Total assets	\$	242,574	\$	234,456	\$	210,776
<hr/>						

PE assets include investment in affiliate of \$0, \$0, and \$2.9 million for the years ended December 31, 2006, 2005 and 2004.

## 17. SIGNIFICANT CONCENTRATIONS

The Company acquires its primary raw materials from various sources. During the years ended December 31, 2006, 2005 and 2004, purchases of primary raw materials from three vendors totaled 90%, 90% and 87%, respectively, of total material purchases. Materials purchased represents the largest component of the Company's cost of sales. The loss of a key supplier could have a significant impact on our business.

Sales to HD Supply, a customer of both the PVC and PE segments, totaled approximately 12% of consolidated sales in 2006. At December 31, 2006, the account receivable balance for HD Supply was 18% of total consolidated accounts receivable. The loss of a large customer could have a significant impact on our business. No customer accounted for more than 10% of our net sales in 2005 or 2004.

## 18. QUARTERLY FINANCIAL DATA (UNAUDITED)

(in thousands, except per share amounts)

<u>Quarter ended:</u>	<hr/>					Year
	March	June	September	December	Ended	
<u>2006</u>						
Net sales	\$ 181,936	\$ 205,242	\$ 189,907	\$ 137,027	\$	714,112
Gross profit	53,964	48,241	50,284	22,153		174,642
Operating income	35,529	28,115	31,457	4,838		99,939
Income before taxes	34,388	26,639	30,948	5,061		97,036
Net income	21,046	16,669	19,829	3,151		60,695
Earnings per share						
Basic	\$1.85	\$1.39	\$1.61	\$0.26		\$5.09
Diluted	\$1.73	\$1.35	\$1.59	\$0.26		\$5.02
<u>2005</u>						
Net sales	\$ 142,640	\$ 161,626	\$ 176,155	\$ 213,823	\$	694,244
Gross profit	23,139	24,305	28,461	83,484		159,389
Operating income	7,986	8,491	9,965	62,339		88,781

Income before taxes	4,217	4,107	5,055	66,714	80,093
Net income	2,696	2,283	2,913	39,058	46,950
Earnings per share					
Basic	\$0.35	\$0.27	\$0.31	\$3.91	\$5.28
Diluted	\$0.27	\$0.23	\$0.30	\$3.56	\$4.65

The summation of quarterly net income per share does not equate to the calculation for the full fiscal year, as quarterly calculations are performed on a discrete basis.

## 19. RELATED PARTY TRANSACTIONS

Certain former members of the Company's Board of Directors were members of Spell Capital Partners, LLC (Spell Capital). On March 30, 2006, the Company terminated its Management Services Agreement (the Agreement), dated January 1, 2004 with Spell Capital, pursuant to which Spell Capital provided the Company with supervisory and monitoring services, as well as advice and assistance with acquisitions, divestitures and financing activities. The Agreement was terminated based on a determination by the Company that the Company no longer required the services of Spell Capital. The terms of the Agreement permitted the Company to not renew the Agreement upon the conclusion of any quarterly term of the Agreement in exchange for a payment to Spell Capital equal to the monthly management fee currently due and owing to Spell Capital along with a payment equal to twenty-four (24) times the current monthly management fee. The amount of the termination payment paid by the Company to Spell Capital was \$1,248,000. The Company's wholly-owned subsidiary, USPoly Company, LLC, also terminated its Management Services Agreement with Spell Capital. The amount of the termination payment paid by USPoly to Spell Capital was \$112,500. These termination fees are included in General and Administrative expenses.

Costs incurred under these arrangements, prior to their termination discussed above, of \$0.2 million, \$0.8 million and \$0.7 million in 2006, 2005 and 2004, respectively, are included in General and Administrative expenses in the consolidated statement of operations. In the fourth quarter of 2005, the Board of Directors approved a bonus payment to Spell Capital of \$0.7 million, which was also included in general and administrative expenses.

During 2004, PW Eagle paid certain operating expenses for USPoly. Transactions with USPoly included the rental of certain operating facilities and expenses related to certain services provided to and delivered by PW Eagle. At December 31, 2004, the inter-company balance was approximately \$0.1 million. On October 17, 2005, USPoly was merged into PW Eagle. All inter-company transactions are eliminated in the consolidated financial statements.

In connection with the UAC Acquisition, USPoly paid Spell Capital a fee of \$0.5 million which is included in transaction costs.

## 20. USPOLY STOCK

In January 2004, the Company's Board of Directors approved USPoly entering into an agreement to issue additional common shares to new investors, thereby resulting in PW Eagle, Inc. no longer owning 100% of USPoly. In connection with the agreement, the new investors contributed approximately \$1.7 million in exchange for approximately 25% of the common stock of USPoly, which includes \$0.3 million from directors, officers and employees. During the fourth quarter of 2004, USPoly management contributed \$0.3 million to purchase USPoly stock. In the first quarter of 2005, USPoly issued \$0.3 million in additional stock at a price of \$1.10 per share. USPoly sold 3.3 million shares of stock in 2004 at prices determined by the Board of Directors of USPoly, ranging from \$0.50 to \$1.10 for a total of \$1.7 million. At December 31, 2004, PW Eagle owned approximately 75% of USPoly. Upon the completion of this transaction, the Company adjusted its investment in USPoly by \$0.9 million to appropriately align the Company's investment with its underlying 75% interest in USPoly. This adjustment was recorded as an increase to the Company's Additional-Paid-In-Capital and a corresponding increase to the Company's Investment in USPoly account.

As explained in Note 2, on October 18, 2005, PW Eagle purchased the remaining shares of USPoly, which it did not previously own.

During 2004, USPoly created a stock option plan under which 2,000,000 shares are authorized for issuance. As of December 31, 2004, USPoly had granted to various directors and employees, at fair value, 531,250 shares, of which 161,265 were exercisable and none were exercised. The 531,250 shares represented less than 4% of USPoly's outstanding stock.

As explained in Note 2, USPoly option holders received PW Eagle options upon the acquisition of the remaining unowned shares of USPoly on October 18, 2005.

## **21. SUBSEQUENT EVENTS**

### *Recently Announced Transaction*

On January 15, 2007, the Company announced that it had entered into a definitive merger agreement under which J-M Manufacturing Company, Inc. ("JMM") will acquire all of the outstanding common shares of PW Eagle for \$33.50 per share in cash. The transaction is expected to be completed during the second quarter of 2007, subject to customary closing conditions, including the receipt of regulatory approvals and approval by the shareholders of PW Eagle. JMM, headquartered in Livingston, New Jersey, operates a total of 14 plastic pipe manufacturing facilities and serves customers throughout North America.

### *Assets Held For Sale*

On January 22, 2007, the Company sold a parcel of land near its West Jordan, Utah plant location. This land has been carried as assets held for sale of \$1.4 million, which is included in Other Assets as of December 31, 2006. This land is part of the assets included under a long-term capital lease obligation. Sale proceeds of \$2.0 million were used to pay \$1.8 million of the capital lease obligation, as well as a prepayment penalty and other selling expenses. This transaction resulted in a net gain on the sale of \$0.4 million.

### *Share Repurchase*

During the months of January and February, 2007, the Company repurchased an additional 460,749 shares of PW Eagle, Inc. common stock for approximately \$15.1 million in accordance with the provisions of the approved share repurchase program (see Note 14). With the inclusion of these shares, the Company has repurchased 990,614 shares of our common stock for \$31.5 million. The Rule 10b5-1 purchase plan entered into on August 21, 2006 provided for \$31.5 million of share repurchases. Therefore, since the maximum dollar common stock share repurchases has been completed under the plan, there will not be additional share repurchases forthcoming under the Rule 10b5-1 purchase plan.

### *Warrant Exercise*

On January 9, 2007, cash conversions of warrants to purchase 20,000 shares of common stock were completed for \$540,000.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

Based on an evaluation conducted by the Company, under the supervision and with the participation of the Company's management, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, (the "Exchange Act")) as of the end of the period covered by this Form 10-K, the principal executive officer and the principal financial officer of the Company have each concluded that such disclosure controls and procedures are effective and sufficient to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules of the Securities and Exchange Commission.

### **Changes in Internal Controls**

There were no changes in the Company's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as this term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over the financial reporting process is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of change in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission on Internal Control—Integrated Framework. Based on our assessment using that criteria, our management concluded that, as of December 31, 2006, the Company's internal control over financial reporting was effective.

Management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

### **Report of Independent Registered Public Accounting Firm**

We have audited management's assessment, included in the accompanying Management's Report on Internal Controls Over Financial Reporting in Item 9A, that PW Eagle, Inc. and its subsidiary maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). PW Eagle and its subsidiary's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that PW Eagle, Inc. and its subsidiary maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, PW Eagle, Inc. and its subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of PW Eagle, Inc. and its subsidiary as of December 31, 2006, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for the year then ended and our report dated March 14, 2007 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP  
Portland, Oregon  
March 14, 2007

#### **ITEM 9B. OTHER INFORMATION**

The registrant has disclosed all information required to be disclosed in a report on Form 8 K during the fourth quarter of the year covered by this Form 10-K.

### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 relating to our directors is incorporated by reference to the sections labeled “Election of Directors” and “Code of Ethics”, and the information relating to section 16(a) of the Exchange Act is incorporated by reference to the section labeled “Section 16(a) Beneficial Ownership Reporting Compliance”, all of which appear in our definitive proxy statement for our 2007 Annual Meeting of Shareholders.

The names, ages and positions of our executive officers are as follows:

Name	Age	Position
Jerry A. Dukes	59	Chief Executive Officer and President
Scott Long	44	Executive Vice President and Chief Financial Officer
N. Michael Stickel	64	Executive Vice President—Sales and Marketing
John R. Cobb	56	Executive Vice President—Operations
Keith H. Steinbruck	57	Vice President—Technical Director
Neil R. Chinn	56	Vice President—Human Resources

Jerry A. Dukes was elected CEO and President of PW Eagle in March 2005 and President of PW Eagle in October 2003. Previously Mr. Dukes had been President of Uponor ETI since 2001, and served as its vice president of manufacturing from 1992 through 2001. Mr. Dukes joined ETI in 1988 as Director of Manufacturing. Prior to ETI, Mr. Dukes was employed by Johns Manville Corp. in various manufacturing and general management positions in plastic pipe and other construction product businesses. He has a B.S. degree from Texas Tech University in Industrial Engineering and is registered as a Professional Engineer in the State of Texas.

Scott Long was elected Executive Vice President and Chief Financial Officer of PW Eagle in March of 2005 and CFO of PW Eagle in October 2003. Previously, Mr. Long was Chairman of Uponor ETI since 2001. He served as president of Uponor ETI since 1998. Mr. Long joined ETI in 1991 as Corporate Controller. From 1994-1998, he held various financial, business development and general management positions within the Uponor organization in the United States and Europe. Prior to joining ETI, Mr. Long was a CPA in public practice. Mr. Long has a B.S. degree in Accounting and Business Administration from the University of Kansas and holds a Colorado CPA certificate (currently in inactive status).

N. Michael Stickel was elected our Executive Vice President—Sales and Marketing in February 2003. Previously, Mr. Stickel was Senior Vice President—Sales and Marketing from February 2001 through 2002. Before joining PW Eagle, Mr. Stickel was Vice President and General Manager for Simpson Paper Company. Mr. Stickel spent 8 years with PWPipe, as Vice President and General Manager of PWResin, a subsidiary of PWPipe, from 1990 through 1993, and as Vice President of Sales and Marketing for PWPipe from 1985 through 1990. Mr. Stickel also served as Vice President of Planning and Control for Longmile Rubber Company from 1981 to 1985 and General Manager of the chemicals division for Simpson Investment Company from 1976 through 1981. Mr. Stickel received a B.S. from Oregon State University and a M.B.A. from the University of Oregon.

John R. Cobb was elected our Executive Vice President—Operations in February 2003. Previously, Mr. Cobb was Senior Vice President—Operations in September 1999 through 2002. Mr. Cobb was Senior Vice President—Operations for PWPipe from 1987 through 1999. Mr. Cobb has also held the positions of production manager and plant manager with PWPipe. Mr. Cobb joined PWPipe in 1978 and has 27 years of experience in the manufacture of plastic pipe. He has received a B.S. degree from the University of Toronto and a M.B.A. from the University of Oregon. Mr. Cobb has also completed the Mahler Advanced Management Skills Program.

Keith H. Steinbruck was elected our Vice President—Technical Director in September 1999 and served through August 2002. Mr. Steinbruck returned to the company and continued to serve as our Vice President—Technical Director in November 2002. Previously, Mr. Steinbruck was Vice President—Technical Director for PWPipe from 1995 through 1999 and Technical Manager of PWPipe from 1982 through 1995. Mr. Steinbruck joined PWPipe in 1973 as a process improvement specialist and has 32 years of experience in the plastic pipe industry. Mr. Steinbruck received a B.A. degree in

industrial technology from San Diego State University and completed the University of California at Berkeley’s Executive Program for Technical Managers.

Neil R. Chinn was elected our Vice President—Human Resources in September 1999. Previously, Mr. Chinn was Vice President—Human Resources for PWPipe from 1995 through 1999 and Employee Relations manager for PWPipe from 1986 through 1995. Mr. Chinn received a B.A. degree from the University of Leicester and M.S. and M.B.A. degrees from the University of Oregon. He has also completed graduate courses at the School of Law, University of Oregon and has attended classes with the American Compensation Association.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item is incorporated by reference to the section labeled “Executive Compensation” to be included in our definitive proxy statement for our 2007 Annual Meeting of Shareholders.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item is incorporated by reference to the section labeled “Security Ownership of Principal Shareholders and Management” to be included in our definitive proxy statement for our 2007 Annual Meeting of Shareholders.

The following table reflects certain information about our equity compensation plans as of December 31, 2006.

(in thousands, except for weighted average exercise price)	Number of securities to be issued upon exercise of outstanding options and warrants	Weighted-average exercise price of outstanding options and warrants	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders			
Stock options	364	\$18.57	374
Warrants	192	\$27.00	—
Equity compensation plans not approved by security holders			
	—	—	—
Total	556	\$21.39	374

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this item is incorporated by reference to the section labeled “Certain Relationships and Related Transactions” to be included in our definitive proxy statement for our 2007 Annual Meeting of Shareholders.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item is incorporated by reference to the section labeled “Audit Fees” to be included in our definitive proxy statement for our 2007 Annual Meeting of Shareholders.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this report:

1. Consolidated Financial Statements

	<u>Page in Form 10-K</u>
Report of Independent Registered Public Accounting Firm (Grant Thornton LLP)	24
Report of Independent Registered Public Accounting Firm (PricewaterhouseCoopers LLP)	25
Statement of Operations	26
Balance Sheet	27
Statement of Stockholders' Equity and Comprehensive Income	28
Statement of Cash Flows	29
Notes to Financial Statements	30-54

2. Consolidated Financial Statement Schedule

Report of Independent Registered Public Accounting Firm on Financial Statement Schedule (PricewaterhouseCoopers LLP)	61
Schedule II Valuation and Qualifying Accounts	62

All schedules omitted are inapplicable or the information required is shown in the financial statements or notes thereto.

3. Exhibits

See Exhibit Index on page following Schedule 11 Valuation and Qualifying Accounts.



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENT  
SCHEDULE**

To the Stockholders and the Board of Directors of PW Eagle, Inc.

Our audit of the consolidated financial statements for the year ended December 31, 2004, referred to in our report dated March 25, 2005 appearing in the 2006 Annual Report on Form 10-K also included an audit of the financial statement schedule listed in Item 15(2) of this Form 10-K for the year ended December 31, 2004. In our opinion, the financial statement schedule for the year ended December 31, 2004 presents fairly in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PricewaterhouseCoopers LLP

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PricewaterhouseCoopers LLP  
Minneapolis, Minnesota  
March 25, 2005

## SCHEDULE II

### Valuation and Qualifying Accounts (in thousands)

Description	Beginning Year Balance	Additions	Assumed Allowance <sup>(2)</sup>	Deductions <sup>(1)</sup>	Year End Balance
Allowance for doubtful accounts and sales discounts					
Fiscal year ended December 31, 2006	\$ 2,061	\$ 11,332	\$ —	\$ 11,728	\$ 1,665
Fiscal year ended December 31, 2005	\$ 1,279	\$ 11,029	\$ —	\$ 10,247	\$ 2,061
Fiscal year ended December 31, 2004	\$ 952	\$ 2,167	\$ 211	\$ 2,051	\$ 1,279

<sup>1</sup> Primarily sales discounts and allowances.

<sup>2</sup> Assumed allowances from the acquisition of ETI and UAC.

## EXHIBIT INDEX

Number	Description
2.1	Merger Agreement, dated September 30, 2005, among the Registrant, Poly Merger, LLC and USPoly Company (Incorporated by reference to the Registrant's Form 8-K filed October 6, 2005).
2.2	Agreement and Plan of Merger, dated January 15, 2007, by and among the Company, Pipe Dream Acquisition, Inc. and J-M Manufacturing Company, Inc. (Incorporated by reference to Exhibit 2.1 to the Registrant's Form 8-K filed January 15, 2007).
3.1	Restated Articles of Incorporation of the Registrant (as corrected by Articles of Correction filed February 6, 2007).**
3.2	Amended and Restated Bylaws of the Registrant (Incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K filed January 15, 2007).
3.3	Statement of designation of shares of Registrant dated May 8, 1997 (Incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K dated May 19, 1997).
10.1	Form of Restricted Stock Agreement between the Registrant and certain officers of the Registrant (Incorporated by reference to Exhibit 10.5 to the Registrant's Form 8-K dated September 20, 1999).*
10.2	Employment Agreement dated September 16, 1999 between the Registrant and Keith H. Steinbruck (Incorporated by reference to Exhibit 10.9 to the Registrant's Form 8-K dated September 20, 1999).*
10.3	Employment Agreement dated September 16, 1999 between the Registrant and John R. Cobb (Incorporated by reference to Exhibit 10.11 to the Registrant's Form 8-K dated September 20, 1999).*
10.4	Employment Agreement dated September 16, 1999 between the Registrant and Neil R. Chinn (Incorporated by reference to Exhibit 10.12 to the Registrant's Form 8-K dated September 20, 1999).*
10.5	Registrant's 1991 stock plan (Incorporated by reference to Exhibit 10.22 to the Registrant's Form 10-K for the year ended December 31, 1992).*
10.6	Registrant's 1997 Stock Option Plan (Incorporated by reference to Exhibit 10.14 to the Registrant's Form 10-K for the year ended December 31, 1996).*
10.7	Amendment to the Employment Agreement executed September 16, 1999 between Keith H. Steinbruck and the Registrant effective as of December 15, 1999 (Incorporated by reference to Exhibit 10.20 to the Registrant's Form 10-K for the year ended December 31, 1999).*
10.8	Amendment to the Employment Agreement executed September 16, 1999 between Neil R. Chinn and the Registrant effective as of December 15, 1999 (Incorporated by reference to Exhibit 10.22 to the Registrant's Form 10-K for the year ended December 31, 1999).*
10.9	Amendment to the Employment Agreement executed September 16, 1999 between John R. Cobb and the Registrant effective as of December 15, 1999 (Incorporated by reference to Exhibit 10.23 to the Registrant's Form 10-K for the year ended December 31, 1999).*
10.10	Employment Agreement effective February 12, 2001 between the Registrant and N. Michael Stickel (Incorporated by reference to Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended June 30, 2001).*
10.11	Form of Restricted Stock Agreement between the Registrant and N. Michael Stickel (Incorporated by reference to Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended June 30, 2001).*

Number	Description
10.12	Second Amendment to the Employment Agreement executed September 16, 1999 between the Registrant and John R. Cobb, Senior Vice President-Operations (Incorporated by reference to Exhibit 10.5 to Registrant's Form 10-Q for the quarter ended September 30, 2001).*
10.13	Second Amendment to the Employment Agreement executed September 16, 1999 between the Registrant and Keith H. Steinbruck, Vice President Technical Director (Incorporated by reference to Exhibit 10.6 to Registrant's Form 10-Q for the quarter ended September 30, 2001).*
10.14	Second Amendment to the Employment Agreement executed September 16, 1999 between the Registrant, and Neil R. Chinn, Vice President of Human Resources (Incorporated by reference to Exhibit 10.7 to Registrant's Form 10-Q for the quarter ended September 30, 2001).*
10.15	Lease Agreement, dated as of February 28, 2002, between PWE (MULTI) QRS 14-85, Inc., as Landlord, and the Registrant, as Tenant (Incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed March 19, 2002).
10.16	Warrant Agreement to purchase 120,000 shares of stock issued to Corporate Property Associates 14 Incorporated dated February 28, 2002 (Incorporated by reference to Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended March 31, 2002).
10.17	First Amendment to Lease Agreement, dated June 7, 2002 by and between PWE (MULTI) QRS 12-85 Inc., and the Registrant (Incorporated by reference to Exhibit 10.3 to Registrant's Form 10-Q for the quarter ended June 30, 2002).
10.18	Second Amendment to Lease Agreement, dated March 10, 2003 by and between PWE (MULTI) QRS 14-85 Inc. and the Registrant (Incorporated by reference to Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended March 31, 2003).
10.19	Lease Agreement, dated as of March 26, 2004 between 406 22nd, LLC, a Minnesota limited liability company, and Damaras Hoppenspirger as landlord, and the Registrant as tenant (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q for the quarter ended March 31, 2004).
10.20	Management Service Agreement between Spell Capital Partners, LLC and the Registrant dated January 1, 2004 (Incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-Q for the quarter ended March 31, 2004).
10.21	Landlord Covenant Waiver dated March 30, 2004, by and between PWE (MULTI) QRS 14-85 Inc. and the Registrant dated March 30, 2004 (Incorporated by reference to Exhibit 10.5 to the Registrant's Form 10-Q for the quarter ended March 31, 2004).
10.22	Lease Agreement dated April 1, 2004 between Continental Properties, LLC a Minnesota limited liability company and PW Poly, Inc. as tenant (Incorporated by reference to Exhibit 10.7 to the Registrant's Form 10-Q for the quarter ended June 30, 2004).
10.23	Lease Agreement dated April 1, 2004 between Continental Properties, LLC and PW Poly, Inc. as tenant (Incorporated by reference to Exhibit 10.8 to the Registrant's Form 10-Q for the quarter ended June 30, 2004).
10.24	Contribution and Membership Interest Purchase Agreement dated September 1, 2004 among Uponor Aldyl Company, Inc., Uponor North American, Inc., Uponor Aldyl Holding Company, LLC and PW Poly Corp (Incorporated by reference to Exhibit 10.9 to the Registrant's Form 10-Q for the quarter ended September 30, 2004).
10.25	Lease dated September 27, 2004 between Uponor Aldyl Company, Inc. as Landlord and PW Poly Corp. as Tenant (Incorporated by reference to Exhibit 10.11 to the Registrant's Form 10-Q for the quarter ended September 30, 2004).
10.26	Third Amendment to Lease Agreement dated October 25, 2004 between PWE (MULTI) QRS 14-85 INC, and the Registrant (Incorporated by reference to Exhibit 10.56 to the Registrant's Form 10-K for the year ended December 31, 2004).

- 10.27 PW Eagle Top-Hat plan (Restated January 1, 2005).\*\*
- 10.28 PW Eagle To-Hat Plan Amendment No. 1, dated January 25, 2007.\*\*
- 10.29 Amended and Restated PVC Resin Supply Agreement dated February 1, 2005 (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q for the quarter ended March 31, 2005).
- 10.30 First Amendment to Senior Subordinated Note Purchase Agreement and Junior Subordinated Note Purchase Agreement between the Registrant and Churchill Capital Partners IV, L.P., dated March 15, 2005 (Incorporated by reference to Exhibit 10.3 to the Registrant's Form 10-Q for the quarter ended March 31, 2005).
- 10.31 First Amendment to Credit and Security Agreement and Waiver of Defaults between USPoly Company and Wells Fargo Business Credit, Inc., dated March 10, 2005 (Incorporated by reference to Exhibit 10.4 to the Registrant's Form 10-Q for the quarter ended March 31, 2005).
- 10.32 First Amendment to Subordination Agreement between Wells Fargo Business Credit, Inc., Medallion Capital, Inc., USPoly Company, and Spell Capital Partners, dated March 10, 2005 (Incorporated by reference to Exhibit 10.5 to the Registrant's Form 10-Q for the quarter ended March 31, 2005).
- 10.33 Warrant issued to Adizes USA, dated September 30, 2005 (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q for the quarter ended September 30, 2005).
- 10.34 Second Amendment to Fourth Amended and Restated Loan and Security Agreement and First Amendment to Subordination Agreement, dated September 30, 2005, among the Company, Bank of America, N.A. and Churchill Capital Partners IV, L.P. (Incorporated by reference to Exhibit 10.2 to the Registrant's Form 10-Q for the quarter ended September 30, 2005).
- 10.35 Common Stock and Warrant Purchase Agreement, dated December 5, 2005 (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed December 9, 2005).
- 10.36 Fifth Amended and Restated Loan and Security Agreement, dated May 3, 2006 between the Company and Fleet Capital Corporation.\*\*
- 10.37 Agreement, dated April 21, 2006, by and among the Company, Pirate Capital LLC, and Jolly Roger Fund LP, Jolly Roger Offshore Fund LTD, and Jolly Roger Activist Portfolio Company LTD (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed April 26, 2006).
- 10.38 Agreement, dated April 21, 2006, by and between the Company and Caxton International Limited (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed April 26, 2006).
- 10.39 Fifth Amended Loan and Security Agreement, dated April 27, 2006, between the Company, USPoly Company and Bank of America, National Association (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed May 2, 2006).
- 10.40 PW Eagle, Inc. Director Compensation Plan\* (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed May 31, 2006).
- 10.41 Form of Change in Control Agreement between the Company and certain of its executive officers (Incorporated by reference to Exhibit 10.1 to the Registrant's Form 8-K filed November 21, 2006).\*
- 10.42 PW Eagle, Inc. Retention Bonus Plan (Incorporated by reference to Exhibit 10.2 to the Registrant's Form 8-K filed November 21, 2006).\*
- 21 List of Subsidiaries of the Registrant: USPoly Company, LLC (State of Organization: Minnesota).

- 23.1 Consent of Grant Thornton LLP, Independent Registered Public Accounting Firm. \*\*
- 23.2 Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm. \*\*
- 24 Power of Attorney from certain directors and officers – see “Signatures” on signature page of this Form 10-K.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*\*
- 31.2 Certification of Chief Financial Officer and Treasurer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. \*\*
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*\*
- 32.2 Certification of Chief Financial Officer and Treasurer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. \*\*

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\* Compensatory plan or arrangement  
\*\* Filed herewith

**Exhibit 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We have issued our report dated March 10, 2006, accompanying the consolidated financial statements included in the Annual Report of PW Eagle Inc. on Form 10-K for the year ended December 31, 2005. We hereby consent to the incorporation by reference of said report in the Registration Statements of PW Eagle, Inc. on Forms S-8 (File Nos. 333-135627, 333-134514, 333-133773, 333-17027, 333-26047, 333-34492, 333-64002) and Form S-1 (File No. 333-130869).

/s/ Grant Thornton LLP

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Grant Thornton LLP

Portland, Oregon  
March 14, 2007

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-135627, 333-134514, 333-133773, 333-17027, 333-26047, 333-34492 and 333-64002) and Form S-1 (File No. 333-130869) of PW Eagle, Inc. (formerly Eagle Plastics Industries, Inc.) of our reports dated March 25, 2005 relating to the financial statements and financial statement schedule which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

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PricewaterhouseCoopers LLP

Minneapolis, Minnesota  
March 14, 2007

**CERTIFICATION**

PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jerry A. Dukes, Chief Executive Officer of PW Eagle, Inc., certify that:

1. I have reviewed this report on Form 10-K of PW Eagle, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 14, 2007

Signature:           /s/ JERRY A. DUKES            
 Jerry A. Dukes  
 Chief Executive Officer

**CERTIFICATION**

PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Scott Long, Chief Financial Officer of PW Eagle, Inc., certify that:

1. I have reviewed this report on Form 10-K of PW Eagle, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 14, 2007

Signature: /s/ SCOTT LONG  
 Scott Long  
 Chief Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of PW Eagle, Inc. (the "Company") on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission (the "Report"), I, Jerry A. Dukes, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 14, 2007

/s/ JERRY A. DUKES

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Jerry A. Dukes  
Chief Executive Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of PW Eagle, Inc. (the "Company") on Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission (the "Report"), I, Scott Long, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 14, 2007

/s/ SCOTT LONG

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Scott Long  
Chief Financial Officer