



Western Forest Products Inc.
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Western Forest Products Inc.

Management's Discussion and Analysis
of Financial Conditions and Results of Operations

Three and nine month periods ended September 30, 2018

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") reports and comments on the financial condition and results of operations of Western Forest Products Inc. (the "Company", "Western", "us", "we", or "our"), on a consolidated basis, for the three and nine months ended September 30, 2018 to help security holders and other readers understand our Company and the key factors underlying our financial results. This discussion and analysis should be read in conjunction with our unaudited condensed consolidated interim financial statements and the notes thereto for the three and nine months ended September 30, 2018, and our audited annual consolidated financial statements and Management's Discussion and Analysis for the year ended December 31, 2017 (the "2017 Annual Report"), which can be found on SEDAR at www.sedar.com.

The Company has prepared the consolidated financial statements for the three and nine months ended September 30, 2018 in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board. Amounts discussed herein are based on our unaudited condensed consolidated interim financial statements and are presented in millions of Canadian dollars unless otherwise noted. Certain prior period comparative figures have been reclassified to conform to the current period's presentation.

Reference is made in this MD&A to adjusted EBITDA¹. Adjusted EBITDA is defined as operating income prior to operating restructuring items and other income (expenses), plus amortization of property, plant, and equipment and intangible assets, impairment adjustments, and changes in fair value of biological assets. Adjusted EBITDA margin is adjusted EBITDA as a proportion of revenue. Western uses adjusted EBITDA and adjusted EBITDA margin as benchmark measurements of our own operating results and as benchmarks relative to our competitors. We consider adjusted EBITDA to be a meaningful supplement to operating income as a performance measure primarily because amortization expense, impairment adjustments and changes in the fair value of biological assets are non-cash costs, and vary widely from company to company in a manner that we consider largely independent of the underlying cost efficiency of their operating facilities. Further, the inclusion of operating restructuring items which are unpredictable in nature and timing may make comparisons of our operating results between periods more difficult. We also believe adjusted EBITDA and adjusted EBITDA margin are commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

Adjusted EBITDA does not represent cash generated from operations as defined by IFRS and it is not necessarily indicative of cash available to fund cash needs. Furthermore, adjusted EBITDA does not reflect the impact of a number of items that affect our net income. Adjusted EBITDA and adjusted EBITDA margin are not measures of financial performance under IFRS, and should not be considered as alternatives to measures of performance under IFRS. Moreover, because all companies do not calculate adjusted EBITDA in the same manner, adjusted EBITDA and adjusted EBITDA margin calculated by Western may differ from similar measures calculated by other companies. A reconciliation between the Company's net income as reported in accordance with IFRS and adjusted EBITDA is included in Appendix A to this report.

Also in this MD&A, management uses key performance indicators such as net debt, net debt to capitalization and current assets to current liabilities. Net debt is defined as long-term debt less cash and cash equivalents. Net debt to capitalization is a ratio defined as net debt divided by capitalization, with capitalization being the sum of net debt and shareholders' equity. Current assets to current liabilities is defined as total current assets divided by total current liabilities. These key performance indicators are non-GAAP financial measures that do not have a standardized meaning and may not be comparable to similar measures used by other issuers. They are not recognized by IFRS; however, they are meaningful in that they indicate the Company's ability to meet its obligations on an ongoing basis, and indicate whether the Company is more or less leveraged than in prior periods.

This MD&A contains statements that may constitute forward-looking statements under the applicable securities laws. Readers are cautioned against placing undue reliance on forward-looking statements. All statements herein, other than statements of historical fact, may be forward-looking statements and can be identified by the use of words such as "will", "estimate", "project", "expect", "anticipate", "plan", "intend", "believe", "seek", "should", "may", "likely", "pursue" and similar references to future periods. Forward-looking statements in this MD&A include, but are not limited to, statements relating to: our current intent, belief or expectations with respect to: market and general economic conditions, accounting standards, future costs, expenditures, available harvest levels and our future operating performance, objectives, capital expenditures and strategies. Although such statements reflect management's current reasonable beliefs, expectations and assumptions as to, amongst other things, the future supply and demand of forest products, global and regional economic activity and the consistency of the regulatory framework within which the Company currently operates, there can be no assurance that forward-looking statements are accurate, and actual results and performance may materially vary. Many factors could cause our actual results or performance to be materially different including: general economic conditions, international demand for lumber, competition and selling prices, international trade disputes, changes in foreign currency exchange rates, labour disruptions, natural disasters, relations with First Nations groups, changes in laws, the availability of allowable annual cut, changes in regulations or public policy affecting the forest industry, changes in opportunities and other factors referenced under the "Risks and Uncertainties" section herein. The foregoing list is not exhaustive, as other factors could adversely affect our actual results and performance. Forward-looking statements are based only on information currently available to us and refer only as of the date hereof. Except as required by law, we undertake no obligation to update forward-looking statements.

Unless otherwise noted, the information in this discussion and analysis is updated to November 7, 2018.

¹ Earnings Before Interest, Tax, Depreciation and Amortization

Summary of Selected Quarterly Results ⁽¹⁾

(millions of dollars except per share amounts and where otherwise noted)

	Q3 2018	Q3 2017	Q2 2018	YTD 2018	YTD 2017	
Summary Information						
Revenue						
Lumber	\$ 238.2	\$ 212.5	\$ 255.6	\$ 722.0	\$ 650.9	
Logs	33.6	55.5	49.0	123.8	158.2	
By-products	20.7	17.2	23.2	66.1	51.2	
Total revenue	\$ 292.5	\$ 285.2	\$ 327.8	\$ 911.9	\$ 860.3	
Export tax	\$ 11.5	\$ 6.5	\$ 11.7	\$ 32.9	\$ 15.7	
Adjusted EBITDA	\$ 32.3	\$ 32.6	\$ 50.2	\$ 125.5	\$ 113.7	
Adjusted EBITDA margin	11.0%	11.4%	15.3%	13.8%	13.2%	
Operating income prior to restructuring items and other income	\$ 23.4	\$ 25.1	\$ 39.7	\$ 95.7	\$ 86.7	
Net income for the period	15.1	13.6	27.1	63.9	55.4	
Basic and diluted earnings per share (in dollars)	\$ 0.04	\$ 0.04	\$ 0.07	\$ 0.16	\$ 0.14	
Operating Information						
Lumber						
Lumber Shipments – millions of board feet ⁽²⁾						
Western Red Cedar	51	56	53	158	178	
Japan Specialty	31	39	35	101	113	
Niche	24	21	25	72	65	
Commodity	106	104	122	331	282	
Total	212	220	235	662	638	
Lumber Production – millions of board feet	221	196	234	664	609	
Lumber Price – per thousand board feet	\$ 1,124	\$ 966	\$ 1,088	\$ 1,091	\$ 1,020	
Logs						
Log Shipments – thousands of cubic metres						
Export	10	163	37	64	375	
Domestic	189	132	337	814	577	
Pulp	109	74	97	262	218	
Total	308	369	471	1,140	1,170	
Net production – thousands of cubic metres ⁽³⁾	815	911	1,348	3,193	2,909	
Saw log purchases – thousands of cubic metres	197	327	305	759	811	
Log Price – per cubic metre ⁽⁴⁾	\$ 109	\$ 134	\$ 104	\$ 109	\$ 124	
Illustrative Lumber Average Price Data⁽⁵⁾						
Grn WRC #2 Clear & Btr 4x6W RL (\$C)	c.i.f. dest. N Euro	\$ 5,150	\$ 4,629	\$ 5,100	\$ 5,089	\$ 4,538
Grn WRC Deck Knotty 2x6 RL S4S	Net f.o.b. Mill	\$ 1,503	\$ 1,535	\$ 1,524	\$ 1,517	\$ 1,469
Grn WRC #2 & Btr AG 6x6 RL	Net f.o.b. Mill	\$ 2,215	\$ 1,853	\$ 2,113	\$ 2,097	\$ 1,747
Coast Grn WRC Std&Btr NH 3/4x4 RL S1S2E	Net f.o.b. Mill	\$ 1,180	\$ 1,195	\$ 1,180	\$ 1,180	\$ 1,122
Grn Hem Baby Squares Merch 4-1/8x4-1/8 13' S4S	c.&f. dest. Japan	\$ 1,000	\$ 790	\$ 995	\$ 932	\$ 755
Grn Dfir Baby Squares Merch 4-1/8x4-1/8 RL S4S	c.&f. dest. Japan	\$ 1,235	\$ 1,040	\$ 1,211	\$ 1,185	\$ 1,016
KD White Fir Shop Moulding&Btr C&Btr 5/4 S2S	Net f.o.b. Mill	\$ 1,080	\$ 1,060	\$ 1,078	\$ 1,073	\$ 1,060
Grn Dfir (Portland) #1&Btr 100% FOHC 6x6 Rough	Net f.o.b. Mill	\$ 1,398	\$ 1,074	\$ 1,398	\$ 1,373	\$ 977
Hemlock Lumber 2x4 (40x90) Metric RG Utility ⁽⁶⁾	c.i.f. dest. Shanghai	\$ 527	\$ 447	\$ 507	\$ 501	\$ 436
Average Exchange Rate – CAD to USD		0.765	0.798	0.775	0.777	0.765
Average Exchange Rate – CAD to JPY		85.32	88.59	84.55	85.14	85.62

(1) Included in Appendix A is a table of selected results from the last eight quarters.

(2) Comparative figures have been reclassified to conform to the current period's presentation, which reflects the reclassification of certain Niche products (Hemlock timbers and US-destined Yellow Cedar) from Commodity and Japan Specialty shipment totals.

(3) Net production is sorted log production, net of residuals and waste.

(4) The log revenue used to determine average price per cubic metre has been reduced by the associated shipping costs arranged in the respective periods to enable comparability of unit prices.

(5) Source: Random Lengths. \$USD/Mfbm, except where noted.

(6) Source: China Bulletin.

Summary of Third Quarter 2018 Results

Adjusted EBITDA for the third quarter of 2018 was \$32.3 million, as compared to \$32.6 million from the same period of last year. Stronger specialty market pricing, an improved supply chain, and a weaker Canadian dollar offset the impacts of incremental US lumber export duties, higher stumpage costs, fire-related operating curtailments, and a significant decline in commodity lumber pricing that impacted sales volumes in the quarter. Operating income prior to restructuring items and other income decreased to \$23.4 million from \$25.1 million in the same period last year.

Sales

Lumber revenue was \$238.2 million, an increase from \$212.5 million in the third quarter of 2017, as continued strong global demand for specialty lumber delivered a 16% increase in average price realizations, despite a weakening sales mix. Total lumber sales volumes decreased by 4%. Western Red Cedar (“WRC”) shipments decreased 9% as the market availability of cedar logs for purchase was significantly reduced due to the severe coastal fire conditions. A lack of Douglas Fir log availability was the primary contributor in a 21% reduction in Japan lumber shipments. Commodity lumber volumes increased to 50% of our lumber shipments from 47% in the same period last year. The Canadian dollar (“CAD”) was 4% lower on average against the United States dollar (“USD”) which helped to offset a weaker lumber sales mix.

Third quarter log revenue was \$33.6 million in 2018, a decrease of \$21.9 million from the same period last year. Improved log market pricing was more than offset by a weaker domestic log sales mix. Log shipments decreased by 17% as compared to the third quarter of 2017 as we suspended our export log sales program to direct additional logs to our mills. Our export log shipments in the period originated from a short-term First Nation timber purchase agreement managed by Western.

By-products revenue increased to \$20.7 million in the third quarter of 2018, from \$17.2 million in the same period in 2017. Higher chip pricing was driven by improved pulp markets and a weaker CAD over the same period last year.

Operations

Lumber production was 221 million board feet, a 13% increase over the third quarter of 2017. Well positioned opening log inventory supported increased sawmill operating hours. Third quarter manufacturing costs were lower than the same period last year due to increased production and a heavier mix of commodity lumber. Increased competition for small diameter logs from the pulp manufacturers and the export market led to a one week curtailment at our Ladysmith sawmill in the quarter.

Third quarter log production was 815,000 cubic metres, 11% lower than the same period last year. Coastal fire conditions led to the full curtailment of timberlands operations for August and early September. During the curtailment, we directed personnel and equipment to aid in coastal BC firefighting efforts. Despite the challenging operating conditions, closing log inventory was 15% higher compared to the same quarter of 2017.

Harvest costs increased by 12% from the third quarter of 2017, primarily driven by higher stumpage rates and reduced production. Coastal stumpage inflation is the result of recent Provincial rate equation updates, the ongoing influence of coastal log exports and rising market pricing.

Saw log purchases were 197,000 cubic metres, a 40% decrease from the same quarter last year. The extent and severity of the fire season, combined with increased demand from pulp manufacturers and export markets, reduced log supply to domestic sawmills and drove log prices higher.

Freight expense decreased by \$4.9 million as compared to the third quarter of 2017. Significantly reduced export log sales and lower lumber shipments to Japan offset the impact of a weaker CAD on USD-denominated freight charges.

Adjusted EBITDA and operating income results for the third quarter of 2018 include \$11.5 million of countervailing duty (“CVD”) and anti-dumping duty (“AD”). In the same quarter last year, we recognized \$6.5 million of export duties as CVD was not in effect after August 25, 2017.

Selling and Administration Expense

Third quarter selling and administration expense was \$6.5 million in 2018, as compared to \$8.6 million in the same period last year. A decline in our common share price over the quarter resulted in a \$1.7 million mark-to-market recovery related to share-based compensation plans.

Net Income

Net income for the third quarter of 2018 was \$15.1 million, as compared to \$13.6 million for the same period of 2017. Operating margins were reduced by higher export taxes, partly offsetting lower freight and restructuring items.

Arlington Operation Update

In the third quarter of 2018, we invested \$5.9 million in Arlington infrastructure and equipment upgrades and 23% of all third quarter US-bound shipments were distributed through the facility. With infrastructure upgrades substantially complete, we will increase the portion of US-bound shipments distributed through Arlington and continue equipment installation. We expect to begin secondary processing operations early in the first quarter of 2019.

Summary of Year to Date 2018 Results

Adjusted EBITDA for the first nine months of 2018 was \$125.5 million, a 10% improvement from the same period in 2017. Operating income prior to restructuring items and other income increased to \$95.7 million from \$86.7 million in the same period last year.

Sales

Lumber revenue increased to \$722.0 million, compared to \$650.9 million in the first nine months of 2017 due to higher sales volumes and price realizations. Average lumber price realizations were 7% higher period-over-period despite proportionately higher commodity sales. Commodity lumber increased to 50% of total lumber shipments in the first nine months of 2018, from 44% in the same period last year. Conversely, WRC lumber shipments declined from 28% to 24% over those same periods, due to reduced coastal log supply.

Log revenue was \$123.8 million in the first nine months of 2018, a decrease of \$34.4 million from the same period of 2017. Lower revenue was the result of the suspension of our export log sales program in 2018 to supply our coastal sawmills, a 2% decrease in overall log shipments and a weaker domestic log sales mix.

By-products revenue increased to \$66.1 million in the first nine months of 2018, from \$51.2 million in the same period in 2017. Lower shipments were offset by a significant increase in chip price realizations, resulting from improved pulp markets.

Operations

Western's results for the first nine months of 2018 include \$32.9 million of export duty expense, an increase of \$17.2 million compared to the same period in 2017. In addition, stumpage costs have increased approximately \$24.7 million in the first nine months of 2018.

Lumber production was 664 million board feet, a 9% increase over the same period of 2017. In addition, we produced 14 million board feet equivalent of custom cut production for a third party in the first quarter of 2018, which are not reflected in our lumber production volume. Higher opening log inventory supported more efficient manufacturing and increased production. Operating costs were driven lower year-over-year through increased sawmill operating hours, a heavier mix of commodity lumber and incremental benefits realized from our strategic capital initiatives.

The recapitalization of our Duke Point sawmill has supported a 25% increase in operating hours compared to the same period last year. We further increased operating hours at Duke Point in the fourth quarter. The ramp-up of our newly rebuilt Duke Point planer operation has supported the reduction of higher-cost, third-party processing volumes, while growing our production of finished lumber products.

The cost benefits of these operating improvements were partly offset by increased production at higher-cost third party custom cut facilities, which we used to optimize cut schedules at our sawmills and grow overall production. Custom cut volumes grew to 10% of total production from 7% in the third quarter of 2017.

Log production for the first nine months of 2018 was 3,193,000 cubic metres, 10% higher than the same period last year, as we capitalized on improved operating conditions in the first half of 2018. Incremental stumpage expense, a greater percentage of grapple yarding and a change in the mix of operations in the first nine months of 2018 contributed to an 8% increase in harvest costs. We partially offset the impact of rising stumpage through our simplified log sort and log flow optimization initiatives, which have led to faster delivery of logs from timberlands to our mills and domestic log customers.

We supplemented our internal log supply with saw log purchases of 759,000 cubic metres, a 6% decrease from the same period last year. Severe fire conditions significantly curtailed coastal harvest and limited market log availability in the third quarter. Increased pricing for purchased logs was driven by strong demand, higher coastal export volumes and fire-related supply constraints.

Freight expense decreased by \$14.0 million as compared to the first nine months of 2017, due primarily to reduced export log shipments.

Selling and Administration Expense

Selling and administration expense for the first nine months of 2018 was \$24.4 million, as compared to \$25.4 million in the same period last year. Mark-to-market recovery related to share-based compensation plans more than offset incremental expense related to foundational system and process improvements in support of our growth strategy.

Net Income

Net income for the first nine months of 2018 was \$63.9 million, as compared to \$55.4 million for the same period of 2017. Improved operating margins and reduced operating restructuring items were partly offset by higher income tax expense.

Operating Restructuring Items

We incurred \$1.7 million of operating restructuring items in the third quarter of 2018, as compared to \$7.1 million in the third quarter of 2017. Operating restructuring items in the third quarter of 2018 include \$0.9 million relating to the remediation of the Nanaimo sawmill site and \$0.5 million relating to the indefinite curtailment of our Somass sawmill. We recognized \$6.2 million in voluntary severance related to the indefinite curtailment of our Somass sawmill in the third quarter of 2017.

Our Somass sawmill remains indefinitely curtailed as a result of a fibre supply deficit arising from years of tenure takebacks and government land use decisions, and rising costs associated with the US Softwood Lumber dispute. We are evaluating options to create a sustainable, long-term solution for the site, and we are considering the input of government, First Nations and other stakeholders.

Income Taxes

We used our remaining non-capital loss carryforwards during the second quarter of 2018, which will result in cash taxes payable for the tax year ending December 31, 2018. Accordingly, current income tax expense of \$6.2 million and deferred income tax recovery of \$0.5 million, respectively, were recognized in net income in the third quarter of 2018. Total income tax expense increased by \$1.5 million from the third quarter of 2017 as a result of higher operating earnings.

In May 2018, the Company received correspondence from the Canada Revenue Agency (“CRA”) regarding certain restructuring transactions, occurring in 2004 and 2007 to 2011, and the general anti-avoidance rule. Management believes the CRA’s position is without merit. Management is prepared to defend its position if a notice of reassessment is issued, and as such, the Company has not recognized any income tax provision as at September 30, 2018 relating to this matter.

Change to Board of Directors

Ms. Suzanne Blanchet tendered her resignation from the Board of Directors effective November 8, 2018, for personal reasons. The Company intends to fill the director vacancy through its ongoing candidate search.

Financial Position and Liquidity

	Q3 2018	Q3 2017	Q2 2018	YTD 2018	YTD 2017
<i>(millions of dollars except where otherwise noted)</i>					
Selected Cash Flow Items					
Operating Activities					
Net income	\$ 15.1	\$ 13.6	\$ 27.1	\$ 63.9	\$ 55.4
Amortization	9.6	9.0	10.9	30.3	26.9
Other	1.2	0.5	10.6	20.7	14.6
Subtotal	25.9	23.1	48.6	114.9	96.9
Change in non-cash working capital	14.2	10.3	(21.7)	(2.3)	34.0
Cash provided by (used in) operating activities	\$ 40.1	\$ 33.4	\$ 26.9	\$ 112.6	\$ 130.9
Investing Activities					
Additions to property, plant and equipment	\$ (17.7)	\$ (11.4)	\$ (14.5)	\$ (43.2)	\$ (28.0)
Additions to capital logging roads	(3.0)	(3.7)	(4.2)	(9.3)	(4.7)
Purchase of Arlington facility	-	-	-	(11.6)	-
Other	0.8	3.5	0.2	1.1	7.0
Cash provided by (used in) investing activities	\$ (19.9)	\$ (11.6)	\$ (18.5)	\$ (63.0)	\$ (25.7)
Financing Activities					
Repayment of debt	\$ -	\$ -	\$ -	\$ -	\$ (35.0)
Dividends	(8.8)	(7.9)	(8.9)	(25.6)	(23.7)
Share repurchases	(10.4)	-	(4.1)	(16.1)	-
Other	(0.3)	0.2	(0.2)	(0.4)	(0.3)
Cash provided by (used in) financing activities	\$ (19.5)	\$ (7.7)	\$ (13.2)	\$ (42.1)	\$ (59.0)
Increase (decrease) in cash	\$ 0.7	\$ 14.1	\$ (4.8)	\$ 7.5	\$ 46.2
Summary of Financial Position					
Cash and cash equivalents	\$ 42.8	\$ 65.2	\$ 42.1		
Current assets	324.6	304.8	345.4		
Current liabilities	146.0	119.2	148.2		
Total debt	-	-	-		
Net debt (cash) ⁽¹⁾	(42.8)	(65.2)	(42.1)		
Shareholders' equity	586.6	555.3	589.1		
Total liquidity ⁽²⁾	291.8	299.2	276.1		
Financial ratios:					
Current assets to current liabilities	2.22	2.56	2.33		
Net debt to capitalization ⁽³⁾	-	-	-		

- (1) Net debt (cash) is defined as the sum of long-term debt and the current portion of long-term debt, less cash and cash equivalents.
- (2) Total liquidity comprises cash and cash equivalents, and available credit under the Company's credit facility.
- (3) Capitalization comprises net debt and shareholders' equity.

In the first nine months of 2018, we invested \$64.1 million in capital including \$19.7 million for the acquisition of and upgrades to our Arlington, Washington distribution and processing facility. We increased our dividend by 12.5%, returning \$25.6 million to shareholders through quarterly dividends, and repurchased \$16.1 million of our common shares while increasing our cash balance by \$7.5 million.

Cash provided by operating activities during the third quarter of 2018 was \$40.1 million, as compared to \$33.4 million during the third quarter of 2017. The reduction of working capital in the third quarter of 2018 resulted from the seasonal draw-down of log inventory.

Cash used in investing activities was \$19.9 million during the third quarter of 2018, as compared to \$11.6 million invested during the same period of 2017. We invested \$8.5 million in strategic capital in the third quarter, including \$5.9 million in building and equipment upgrades at our Arlington operation. Our strategic capital program is discussed in more detail in the "Strategy and Outlook" section.

Cash used in financing activities was \$19.5 million during the third quarter of 2018, as compared to cash used in financing activities of \$7.7 million during the same period of 2017. Incremental cash used in financing activities in the quarter reflects \$10.4 million used to repurchase common shares for cancellation under our normal course issuer bid and a 12.5% increase in our quarterly dividend amount.

Liquidity

On August 8, 2018, we announced the execution of a new \$250 million syndicated credit facility. The facility, which matures on August 1, 2022, includes an accordion feature to access an additional \$100 million of debt.

Total liquidity increased to \$291.8 million at September 30, 2018, from \$269.3 million at the end of 2017. Liquidity is comprised of cash and cash equivalents of \$42.8 million and unused availability under the credit facility of \$249.0 million. Based on our current forecasts, we expect sufficient liquidity will be available to meet our obligations in 2018.

Capital Allocation

Normal Course Issuer Bid

On August 3, 2018, we announced the renewal of our normal course issuer bid permitting us to purchase and cancel up to 19,662,439 of our common shares (“Shares”) or approximately 5% of our Shares issued and outstanding.

We accelerated Share repurchases in the three months ended September 30, 2018. We repurchased 4,592,400 Shares for cancellation at an average price of \$2.27, or \$10.4 million in aggregate, in that period.

We have purchased and cancelled a total of 7,858,705 Shares under the normal course issuer bid at an average price of \$2.39 per Share, or \$18.8 million in aggregate.

Strategy and Outlook

Western’s long-term business objective is to create superior value for shareholders by building a margin-focused log and lumber business of scale to compete successfully in global softwood markets. We believe this will be achieved by maximizing the sustainable utilization of our forest tenures, operating safe, efficient, low-cost manufacturing facilities and producing and selling high-value specialty products for global markets. We seek to manage our business with a focus on operating cash flow and maximizing the value of our fibre resource through the production cycle, from the planning of our logging operations to the production, marketing, sale and delivery of our log and lumber products. We routinely evaluate our performance using the measure Return on Capital Employed.

For more detail on our strategic initiatives and actions, refer to “*Strategy and Outlook*” in our Management’s Discussion and Analysis for the year ended December 31, 2017.

Sales & Marketing Strategy Update

We are progressing with the execution of our sales and marketing strategy that focuses on the production and sale of targeted, high-margin products of scale to selected customers. We supplement our key product offerings with purchased lumber to deliver the suite of products our customers require. To accelerate and lead our sales and marketing initiatives, we are pleased to announce the following executive management additions.

Bruce Alexander will join Western in the fourth quarter of 2018 as the Senior Vice President, Sales, Marketing and Manufacturing. Mr. Alexander is an experienced executive and brings over 30 years of sales, manufacturing and management experience in the forest products and manufacturing industries, including on the coast of BC. Mr. Alexander will be responsible for positioning Western as the leading global supplier of specialty building materials. Common leadership of sales, marketing and manufacturing business units will drive alignment between these functions, and is expected to optimize the production of targeted products of scale and grow our selected customer base worldwide.

Don McGregor joined Western as Vice President, Wholesale Lumber in October 2018. Mr. McGregor brings almost 30 years of lumber marketing experience, including more than 20 years as President of Vanport Canada, a leading wholesale lumber company. Mr. McGregor is responsible for leading wholesale lumber operations and, in building relationships with global suppliers, broadening the scope of our specialty product offerings. Through the existing industry-leading product portfolio and complementary supply from new supply relationships, Don will expand product offerings to deliver greater value to our selected customers.

Market Outlook

Despite the recent volatility in commodity lumber, long-term market fundamentals remain unchanged. In North America, rising lumber consumption is being driven by increased new home construction and a robust repair and renovation sector. Strong economic growth in China and a government commitment to housing is supporting increased demand for lumber, while in Japan lumber consumption remains steady.

On a year-to-date basis, we have increased China lumber shipments by 5% while the overall decline in revenue from China is due to temporarily suspending our export log sales program. As noted above, lumber shipments to Japan have declined due to limited Douglas Fir log availability.

Specialty lumber demand has remained relatively strong despite volatile commodity lumber markets. In North America, supply has exceeded demand for commodity lumber as new home construction has been somewhat weaker than expected. In response, buyers in North American and China slowed purchasing in the quarter in anticipation of continued price declines. We expect markets to remain volatile through the seasonally slower fourth quarter.

North American demand for our WRC products remains generally stable however we are experiencing typical fourth quarter seasonal weakness, particularly in the oversupplied narrow-width market. Commodity market uncertainty is expected to have an impact on pricing for our Niche and Japan products.

Declining lumber markets have started to influence domestic saw log pricing. We expect to see lower log prices as we move through the fourth quarter. In contrast we expect improved pulp log pricing due to limited log supply.

Softwood Lumber Dispute and US Market Update

During the third quarter of 2018, we expensed \$8.0 million of CVD and \$3.5 million of AD for a total of \$11.5 million, as compared to \$6.5 million in the third quarter of 2017. As at September 30, 2018, the balance of CVD and AD on deposit was \$50.3 million.

On January 3, 2018, US Department of Commerce published amended final determinations, resulting in reduced, final CVD and AD rates of 14.19% and 6.04% respectively for “all other” Canadian lumber producers including Western.

In May 2018, we filed a North American Free Trade Agreement challenge to contest the US International Trade Commission’s (“ITC”) finding that goods manufactured from Cedar (including WRC, Yellow Cedar and Redwood species) were not a separate product group from lumber manufactured from other softwood species.

We are seeking ITC recognition that appearance-grade Cedar lumber products and structural commodity lumber differ in end-use application. A successful outcome could result in “separate like product” classification and separate duty rates for Cedar products and could position Cedar for exclusion from future softwood lumber disputes and determinations.

Rebuttal briefs from the US Lumber Coalition and US International Trade Commission were received in October 2018, and we anticipate filing a response in December 2018. US-bound WRC products account for approximately 85% of our total duty expense since April 2017.

The US application of duties continues a long-standing pattern of US protectionist action against Canadian lumber producers. We disagree with the US trade determination and the inclusion of specialty lumber products in this commodity lumber focused dispute.

Our shipments to the US market are predominantly high-value, appearance grade lumber, representing less than 25% of Western’s total revenue in 2017. Continued strong demand and a lack of supply has supported ongoing improvements in our specialty lumber product pricing, partly offsetting the impact of duties.

Our recent acquisition of a distribution and processing centre in Arlington, Washington is expected to assist in mitigating the damaging effects of duties on our products destined for the US market while increasing US market sales. We intend to preserve our strong balance sheet and leverage our flexible operating platform to continue to overcome any challenges that arise from this trade dispute.

For a more detailed timeline of recent history of the softwood lumber dispute, refer to “*Risks and Uncertainties – Softwood Lumber Dispute*” in our Management’s Discussion and Analysis for the year ended December 31, 2017.

Strategic Capital Program Update

We continue to implement a strategic capital program that is designed to position Western as the only company capable of sustainably consuming the complete profile of the coastal forest and competitively manufacturing a diverse product mix for global markets.

Our strategic capital program is focused on the installation of technology that will deliver top quartile performance and improve our ability to manufacture targeted products that yield the best margin. In addition to investments in our manufacturing assets, we also allocate capital to strategic, high-return projects involving our information systems, timberlands assets, and forest inventories.

In the third quarter of 2018, we continued to make advancements with the latest phase of the Duke Point planer rebuild and auto-grading addition, and progressed on a number of small, high-return capital projects focused on debottlenecking our manufacturing operations. We expect to complete the latest phase of the Duke Point planer rebuild and auto-grading addition in the fourth quarter of 2018.

Non-GAAP Measures

Reference is made in this MD&A to the following non-GAAP measures: Adjusted EBITDA, Adjusted EBITDA margin, and Net debt to capitalization are used by the Company as benchmark measurements of our own operating results and as benchmarks relative to our competitors. We also believe adjusted EBITDA and adjusted EBITDA margin are commonly used by securities analysts, investors and other interested parties to evaluate our financial performance. These non-GAAP measures do not have any standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other issuers. The following table provides a reconciliation of these non-GAAP measures to figures as reported in the Company's unaudited interim consolidated financial statements prepared in accordance with IFRS:

<i>(millions of dollars except where otherwise noted)</i>	Q3 2018	Q3 2017	Q2 2018	YTD 2018	YTD 2017
Adjusted EBITDA					
Net income	\$ 15.1	\$ 13.6	\$ 27.1	\$ 63.9	\$ 55.4
Add:					
Amortization	9.6	9.0	10.9	30.3	26.9
Changes in fair value of biological assets, net	(0.8)	(1.4)	(0.2)	(0.5)	0.1
Operating restructuring items	1.7	7.1	1.3	5.2	11.3
Other (income) expense ⁽¹⁾	-	(0.4)	0.1	0.2	(0.7)
Finance costs	0.9	0.6	0.6	2.0	2.0
Current income tax (recovery) expense	6.2	0.1	8.0	14.3	0.2
Deferred income tax expense	(0.5)	4.1	2.6	10.1	18.5
Adjusted EBITDA	<u>\$ 32.3</u>	<u>\$ 32.6</u>	<u>\$ 50.2</u>	<u>\$ 125.5</u>	<u>\$ 113.7</u>
Adjusted EBITDA margin					
Total revenue	\$ 292.5	\$ 285.2	\$ 327.8	\$ 911.9	\$ 860.3
Adjusted EBITDA	32.3	32.6	50.2	125.5	113.7
Adjusted EBITDA margin	11.0%	11.4%	15.3%	13.8%	13.2%
Net debt to capitalization					
Net debt					
Total debt	\$ -	\$ -	\$ -		
Cash and cash equivalents	(42.8)	(65.2)	(42.1)		
Net debt (cash)	<u>\$ (42.8)</u>	<u>\$ (65.2)</u>	<u>\$ (42.1)</u>		
Capitalization					
Net debt (cash)	\$ (42.8)	\$ (65.2)	\$ (42.1)		
Add: Shareholders' equity	586.6	555.3	589.1		
Capitalization	<u>\$ 543.8</u>	<u>\$ 490.1</u>	<u>\$ 547.0</u>		
Net debt to capitalization	-	-	-		

Figures in the table above may not equal or sum to figures presented elsewhere due to rounding.

(1) Other (income) expense, net of changes in fair market value less cost to sell of biological assets.

Included in the net income to adjusted EBITDA reconciliation for the third quarter of 2017 was \$6.2 million of severance related to the indefinite curtailment of our Somass sawmill.

Accounting Policies and Standards

Please refer to Note 3 of our unaudited condensed consolidated interim financial statements for the three and nine months ended September 30, 2018 for further information on the new accounting standards referenced below.

New Accounting Standards

The Company has adopted the following standards with a date of initial application of January 1, 2018, which had no significant impact on the Company's interim financial statements:

- IFRS 15, *Revenue from Contracts with Customers*
- IFRS 9, *Financial Instruments*

Accounting Standards Not Yet Applied

A number of new and amended IFRS standards are not yet effective for the year ended December 31, 2018 and have not been applied in preparing these interim financial statements. IFRS 16 *Leases* is considered by the Company to be the most significant of several pronouncements that may affect future financial statements. The Company intends to adopt IFRS 16 in its consolidated financial statements for the year commencing January 1, 2019.

The Company plans to apply a modified retrospective approach upon adoption of IFRS 16. Under the modified retrospective approach, the Company will calculate the right of use assets and lease liabilities as at January 1, 2019 and will not restate comparative information. Rather, the Company will recognize the cumulative effect of initially applying the standard as an adjustment to equity at the date of application. The Company continues to evaluate the impact of adopting the new standard which will be completed and disclosed in the consolidated financial statements in the first quarter of 2019. The Company anticipates that upon transition, the impact to its consolidated financial statements will be an increase in non-current assets and liabilities of less than 3% of total assets. Following adopting this standard, the consolidated statement of comprehensive income will recognize depreciation in cost of goods sold and finance costs for operating lease payments previously expensed in cost of goods sold.

Critical Accounting Estimates

For a review of significant management judgements affecting financial results and critical accounting estimates, please see our 2017 Annual reporting, which can be found on SEDAR at www.sedar.com.

Financial Instruments and Other Instruments

We use various financial instruments to reduce the impact of movement in foreign exchange rates on our net income. Please see our Management Discussion and Analysis for the year ended December 31, 2017 for a further discussion on our use of financial instruments.

Off-Balance Sheet Arrangements

Other than operating leases for vehicles, equipment and machinery, the Company does not have any off-balance sheet arrangements as at September 30, 2018.

Related Party Transactions

Other than transactions in the normal course of business with the Board of Directors and key management personnel, the Company had no transactions between related parties in the first quarter ended September 30, 2018.

Risks and Uncertainties

The business of the Company is subject to a number of risks and uncertainties, including those described in the 2017 Annual Report which can be found on SEDAR at www.sedar.com. Any of the risks and uncertainties described in the above-noted document could have a material adverse effect on our operations and financial condition and cash flows and, accordingly, should be carefully considered in evaluating Western's business.

Evaluation of Disclosure Controls and Procedures

There have been no changes in the Company's internal controls over financial reporting ("ICFR") during the three months ended September 30, 2018, that have materially affected or are reasonably likely to materially affect, its ICFR.

Outstanding Share Data

As of November 7, 2018, there were 388,656,387 common shares of the Company issued and outstanding.

We have reserved 30,000,000 of our Shares for issuance upon the exercise of options granted under our incentive stock option plan. During the nine months ended September 30, 2018, 1,235,788 options were granted and 660,000 previously granted options were exercised. As of November 7, 2018, 12,294,271 options were outstanding under our incentive stock option plan.

Additional Information

Additional information relating to the Company and its operations, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

Management's Discussion and Analysis – Appendix A

Summary of Selected Results for the Last Eight Quarters

(millions of dollars except per share amounts and where noted)	2018			2017				2016	
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	
Average Exchange Rate – USD to CAD	1.307	1.291	1.265	1.271	1.253	1.345	1.323	1.334	
Average Exchange Rate – CAD to USD	0.765	0.775	0.791	0.787	0.798	0.744	0.756	0.749	
Financial Performance									
Revenue									
Lumber	\$ 238.2	\$ 255.6	\$ 228.2	\$ 207.3	\$ 212.5	\$ 212.8	\$ 225.6	\$ 220.7	
Logs	33.6	49.0	41.2	56.6	55.5	57.2	45.5	55.1	
By-products	20.7	23.2	22.2	19.2	17.2	17.4	16.6	17.2	
Total revenue	\$ 292.5	\$ 327.8	\$ 291.6	\$ 283.1	\$ 285.2	\$ 287.4	\$ 287.7	\$ 293.0	
Adjusted EBITDA	\$ 32.3	\$ 50.2	\$ 43.0	\$ 38.9	\$ 32.6	\$ 47.1	\$ 34.0	\$ 33.8	
Adjusted EBITDA margin	11.0%	15.3%	14.7%	13.7%	11.4%	16.4%	11.8%	11.5%	
Earnings per share:									
Net income, basic and diluted	\$ 0.04	\$ 0.07	\$ 0.05	\$ 0.05	\$ 0.04	\$ 0.06	\$ 0.04	\$ 0.09	
Operating Statistics									
Lumber⁽¹⁾									
Production	mmfbm	221	234	209	184	196	204	209	237
Shipments	mmfbm	212	235	215	200	220	194	225	231
Price	\$/mfbm	\$ 1,124	\$ 1,088	\$ 1,061	\$ 1,037	\$ 966	\$ 1,097	\$ 1,003	\$ 955
Logs⁽²⁾									
Net production	000 m ³	815	1,348	1,029	1,099	911	1,091	908	919
Saw log purchases	000 m ³	197	305	257	343	327	249	231	337
Log availability	000 m ³	1,012	1,653	1,286	1,442	1,238	1,340	1,139	1,256
Shipments	000 m ³	308	471	361	494	369	436	364	493
Price ⁽³⁾	\$/m ³	\$ 109	\$ 104	\$ 114	\$ 107	\$ 134	\$ 122	\$ 116	\$ 104
Share Repurchases and Dividends									
Shares repurchased (millions)		4.6	1.6	0.6	1.1	-	-	-	-
Shares repurchased	\$	\$ 10.4	\$ 4.1	\$ 1.6	\$ 2.7	\$ -	\$ -	\$ -	\$ -
Dividends paid	\$	\$ 8.8	\$ 8.9	\$ 7.9	\$ 7.9	\$ 7.9	\$ 7.9	\$ 7.9	\$ 7.9

Figures in the table above may not equal or sum to figures presented elsewhere due to rounding.

(1) "mmfbm" = millions of board feet; "mfbm" = thousands of board feet.

(2) Net production is sorted log production, net of residuals and waste. Log availability is net production plus saw log purchases.

(3) The log revenue used to determine average price per cubic metre has been reduced by the associated shipping costs arranged in the respective periods to enable comparability of unit prices.

In a normal operating year there is seasonality to the Company's operations with higher lumber sales in the second and third quarters when construction activity, particularly in the US, has historically tended to be higher. Logging activity may also vary depending on weather conditions such as rain, snow and ice in the winter and the threat of forest fire in the summer.