



Western Forest Products Inc.
DEFINING A HIGHER STANDARD™

Western Forest Products Inc.

Unaudited Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2018 and 2017

Western Forest Products Inc.
Condensed Consolidated Statements of Financial Position
(Expressed in millions of Canadian dollars) (unaudited)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 42.8	\$ 35.3
Trade and other receivables ^(Note 17)	88.6	86.2
Inventory ^(Note 5)	178.2	152.0
Prepaid expenses and other assets	15.0	19.0
	<u>324.6</u>	<u>292.5</u>
Non-current assets:		
Property, plant and equipment ^(Note 6)	349.5	313.9
Timber licenses	114.1	117.2
Biological assets ^(Note 7)	58.7	58.2
Other assets	16.7	17.5
Deferred income tax assets ^(Note 9)	0.3	0.3
	<u>\$ 863.9</u>	<u>\$ 799.6</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 136.1	\$ 98.9
Reforestation obligation ^(Note 10)	9.9	8.9
	<u>146.0</u>	<u>107.8</u>
Non-current liabilities:		
Reforestation obligation ^(Note 10)	14.5	16.4
Deferred income tax liabilities ^(Note 9)	39.2	28.1
Other liabilities ^(Note 11)	22.7	28.2
Deferred revenue ^(Note 17)	54.9	56.4
	<u>277.3</u>	<u>236.9</u>
Shareholders' equity:		
Share capital ^(Note 12)	497.4	505.5
Contributed surplus	9.1	8.7
Retained earnings	80.1	48.5
	<u>586.6</u>	<u>562.7</u>
	<u>\$ 863.9</u>	<u>\$ 799.6</u>

Commitments and Contingencies ^(Note 13)

See accompanying notes to these unaudited condensed consolidated interim financial statements.

Approved on behalf of the Board:

"Lee Doney"
Chairman

"Don Demens"
President and CEO

Western Forest Products Inc.
Condensed Consolidated Statements of Comprehensive Income
(Expressed in millions of Canadian dollars except for share and per share amounts) (unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenue ^(Note 17)	\$ 292.5	\$ 285.2	\$ 911.9	\$ 860.3
Costs and expenses:				
Cost of goods sold	229.3	218.3	692.7	652.3
Freight	21.8	26.7	66.2	80.2
Export tax ^(Note 13)	11.5	6.5	32.9	15.7
Selling and administration	6.5	8.6	24.4	25.4
	<u>269.1</u>	<u>260.1</u>	<u>816.2</u>	<u>773.6</u>
Operating income prior to restructuring items and other expense	<u>23.4</u>	<u>25.1</u>	<u>95.7</u>	<u>86.7</u>
Operating restructuring items ^(Note 16)	(1.7)	(7.1)	(5.2)	(11.3)
Other income (expense)	-	0.4	(0.2)	0.7
	<u>21.7</u>	<u>18.4</u>	<u>90.3</u>	<u>76.1</u>
Operating income	<u>21.7</u>	<u>18.4</u>	<u>90.3</u>	<u>76.1</u>
Finance costs	(0.9)	(0.6)	(2.0)	(2.0)
Income before income taxes	<u>20.8</u>	<u>17.8</u>	<u>88.3</u>	<u>74.1</u>
Current income tax expense ^(Note 9)	(6.2)	(0.1)	(14.3)	(0.2)
Deferred income tax recovery (expense) ^(Note 9)	0.5	(4.1)	(10.1)	(18.5)
	<u>(5.7)</u>	<u>(4.2)</u>	<u>(24.4)</u>	<u>(18.7)</u>
Net income	<u>15.1</u>	<u>13.6</u>	<u>63.9</u>	<u>55.4</u>
Other comprehensive income				
Items that will not be reclassified to profit or loss:				
Defined benefit plan actuarial gain ^(Note 14)	1.9	2.6	1.0	0.6
Income tax on other comprehensive gain ^(Note 9)	(0.5)	(0.7)	(0.3)	(0.2)
Total items that will not be reclassified to profit or loss	<u>1.4</u>	<u>1.9</u>	<u>0.7</u>	<u>0.4</u>
Other comprehensive income for the period	<u>1.4</u>	<u>1.9</u>	<u>0.7</u>	<u>0.4</u>
Total comprehensive income	<u>\$ 16.5</u>	<u>\$ 15.5</u>	<u>\$ 64.6</u>	<u>\$ 55.8</u>
Net income per share (in dollars)				
Basic and diluted earnings per share	\$ 0.04	\$ 0.04	\$ 0.16	\$ 0.14
Weighted average number of common shares outstanding (thousands)				
Basic	392,194	395,721	393,945	395,550
Diluted	395,904	400,403	398,171	399,412

See accompanying notes to these unaudited condensed consolidated interim financial statements.

Western Forest Products Inc.
Condensed Consolidated Statements of Changes in Shareholders' Equity
(Expressed in millions of Canadian dollars) (unaudited)

	Share Capital	Contributed Surplus	Retained Earnings	Total Equity
Balance at December 31, 2016	\$ 506.0	\$ 8.6	\$ 7.9	\$ 522.5
Net income	-	-	55.4	55.4
Other comprehensive gain:				
Defined benefit plan actuarial gain recognized	-	-	0.6	0.6
Income tax expense on other comprehensive gain	-	-	(0.2)	(0.2)
Total comprehensive income	-	-	55.8	55.8
Share-based payment transactions recognized in equity	-	0.2	-	0.2
Exercise of stock options	0.8	(0.3)	-	0.5
Dividends	-	-	(23.7)	(23.7)
Total transactions with owners, recorded directly in equity	0.8	(0.1)	(23.7)	(23.0)
Balance at September 30, 2017	\$ 506.8	\$ 8.5	\$ 40.0	\$ 555.3
Balance at December 31, 2017	\$ 505.5	\$ 8.7	\$ 48.5	\$ 562.7
Net income	-	-	63.9	63.9
Other comprehensive gain:				
Defined benefit plan actuarial gain recognized	-	-	1.0	1.0
Income tax expense on other comprehensive gain	-	-	(0.3)	(0.3)
Total comprehensive income	-	-	64.6	64.6
Share-based payment transactions recognized in equity ^{(Note 12(b))}	-	0.6	-	0.6
Exercise of stock options	0.6	(0.2)	-	0.4
Repurchase of shares ^{(Note 12(a))}	(8.7)	-	(7.4)	(16.1)
Dividends	-	-	(25.6)	(25.6)
Total transactions with owners, recorded directly in equity	(8.1)	0.4	(33.0)	(40.7)
Balance at September 30, 2018	\$ 497.4	\$ 9.1	\$ 80.1	\$ 586.6

See accompanying notes to these unaudited condensed consolidated interim financial statements.

Western Forest Products Inc.
Condensed Consolidated Statements of Cash Flows
(Expressed in millions of Canadian dollars) (unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Cash provided by (used in):				
Operating activities:				
Net income	\$ 15.1	\$ 13.6	\$ 63.9	\$ 55.4
Items not involving cash:				
Amortization of property, plant and equipment ^(Note 6)	8.7	8.0	27.3	23.9
Amortization of timber licenses	0.9	1.0	3.0	3.0
Gain on disposal of assets	-	(1.3)	(0.3)	(3.6)
Impairment of assets	-	0.5	0.3	3.2
Change in fair value of biological assets ^(Note 7)	(0.8)	(1.4)	(0.5)	0.1
Change in reforestation obligation ^(Note 10)	(0.3)	(1.2)	(0.9)	(4.1)
Amortization of deferred revenue	(0.5)	(0.5)	(1.5)	(1.5)
Share-based compensation, including mark-to-market adjustment	(1.0)	1.2	1.7	4.1
Net finance costs	0.9	0.6	2.0	2.0
Income tax expense ^(Note 9)	5.7	4.2	24.4	18.7
Change in pension liability ^(Note 14)	(0.7)	(0.5)	(2.3)	(1.8)
Other	(2.1)	(1.1)	(2.2)	(2.5)
	<u>25.9</u>	<u>23.1</u>	<u>114.9</u>	<u>96.9</u>
Changes in non-cash working capital items:				
Trade and other receivables	5.5	4.3	(2.4)	19.7
Inventory	14.0	(0.4)	(26.2)	13.0
Prepaid expenses and other assets	2.1	(2.6)	4.0	(2.3)
Accounts payable and accrued liabilities	(7.4)	9.0	22.3	3.6
	<u>14.2</u>	<u>10.3</u>	<u>(2.3)</u>	<u>34.0</u>
	<u>40.1</u>	<u>33.4</u>	<u>112.6</u>	<u>130.9</u>
Investing activities:				
Additions to property, plant and equipment ^(Note 6)	(20.7)	(15.1)	(52.5)	(32.7)
Purchase of Arlington facility ^(Note 6)	-	-	(11.6)	-
Proceeds on disposal of assets	0.8	3.5	1.1	7.0
	<u>(19.9)</u>	<u>(11.6)</u>	<u>(63.0)</u>	<u>(25.7)</u>
Financing activities:				
Interest paid	(0.3)	(0.2)	(0.8)	(0.9)
Repayment of long-term debt	-	-	-	(35.0)
Repurchase of shares ^{(Note 12)(a)}	(10.4)	-	(16.1)	-
Dividends	(8.8)	(7.9)	(25.6)	(23.7)
Proceeds from exercise of stock options	-	0.4	0.4	0.6
	<u>(19.5)</u>	<u>(7.7)</u>	<u>(42.1)</u>	<u>(59.0)</u>
Increase in cash and cash equivalents	0.7	14.1	7.5	46.2
Cash and cash equivalents, beginning of period	42.1	51.1	35.3	19.0
Cash and cash equivalents, end of period	<u>\$ 42.8</u>	<u>\$ 65.2</u>	<u>\$ 42.8</u>	<u>\$ 65.2</u>

See accompanying notes to these unaudited condensed consolidated interim financial statements.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2018 and 2017

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

1. Reporting entity

Western Forest Products Inc. ("Western" or the "Company") is an integrated softwood forest products company, incorporated and domiciled in Canada, operating in the coastal region of British Columbia and Washington State. The address of the Company's head office is Suite 800 – 1055 West Georgia Street, Vancouver, British Columbia ("BC"), Canada. The unaudited condensed consolidated interim financial statements as at and for the three and nine months ended September 30, 2018 and 2017 comprise financial results of the Company and its subsidiaries. The Company's primary business is the sale of lumber and logs, which includes timber harvesting, sawmilling logs into specialty lumber and value-added lumber remanufacturing. The Company is listed on the Toronto Stock Exchange, under the symbol WEF.

2. Basis of preparation

(a) Statement of compliance

These unaudited condensed consolidated interim financial statements ("interim financial statements") have been prepared in accordance with IAS 34, *Interim Financial Reporting* ("IAS 34"). Selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the Company since the last annual consolidated financial statements as at and for the year ended December 31, 2017. These interim financial statements do not include all the information required for full annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). Certain prior period comparative figures have been reclassified to conform to the current period's presentation.

The interim financial statements were authorized for issue by the Board of Directors on November 7, 2018.

(b) Basis of measurement

The interim financial statements have been prepared on the historical cost basis except for the following material items in the statement of financial position:

- Biological assets are measured at fair value less costs to sell;
- Liabilities for cash-settled share-based payment transactions are measured at fair value at each reporting date;
- Equity-settled share-based payments are measured at fair value at grant date;
- Derivative financial instruments are measured at fair value at each reporting date;
- The defined benefit pension liability is recognized as the net total of the fair value of the plan assets, less the present value of the defined benefit obligation; and,
- Reforestation obligations are measured at the discounted value of expected future cash flows.

(c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars which is the Company's functional currency. All amounts are presented in millions of Canadian dollars, unless otherwise indicated.

(d) Use of estimates and judgements

The preparation of interim consolidated financial statements in accordance with IAS 34 requires Management to make estimates, judgements and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the interim financial statements, are disclosed in the Company's annual consolidated financial statements as at and for the year ended December 31, 2017.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2018 and 2017

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

3. Significant accounting policies

Except as described as below, the accounting policies applied by the Company in these interim financial statements are the same as those applied by the Company in its annual consolidated financial statements as at and for the year ended December 31, 2017.

(a) Changes to significant accounting policies

IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

The Company has adopted IFRS 15, *Revenue from Contracts with Customers* with a date of initial application of January 1, 2018. The adoption of IFRS 15 does not have a material impact on these interim financial statements, other than in the form of additional disclosures included herein. The Company has updated its accounting policy for revenue recognition to reflect the qualitative changes of the new standard, as set out below.

In the comparative period, revenue was measured at the fair value of consideration received or receivable, net of rebates and discounts. Revenue from sale of goods was recognized when the significant risks and rewards of ownership had been transferred to the customer, recovery of the consideration was probable, the associated costs and possible return of goods could be estimated reliably, there was no continuing management involvement with the goods and the amount of revenue could be measured reliably.

Significant accounting policy

Revenue from the sale of goods is measured based on the consideration specified in a contract with a customer, net of rebates and discounts, and after eliminating intercompany sales. Revenue is recognized when control over a product transfers from the Company to the customer. The timing of transfer of control varies depending on the individual term of the contract of sale.

Amounts charged to customers for shipping and handling are recognized as revenue as services are provided, and shipping and handling costs, lumber duties, and export taxes incurred by the Company are recorded in costs and expenses.

Nature of goods and services

The following is a description of principal activities from which the Company generates its revenue.

i. Lumber

Revenue is recognized when control over lumber is transferred to the customer. The timing of transfer of control varies depending on the individual terms of the contract of sale, but is typically at the time lumber is loaded onto the mode of transportation. The amount of revenue recognized is adjusted for discounts related to early payment at the point in time control is transferred, based on historical experience.

ii. Logs

Revenue is recognized when control over logs is transferred to the customer. The timing of transfer of control varies depending on the individual terms of the contract of sale, but is typically at the time logs are loaded onto the vessel or delivered to the transfer point, and payment is secured. No discounts are offered for logs.

iii. By-products

Revenue is recognized when control over by-products is transferred to the customer, the timing of this transfer of control varies depending on the individual terms of the contract of sale, but is typically at the time by-products leave the Company's facilities or are scaled at the pick-up location. Invoices are generated and revenue is recognized at that point in time. No discounts are offered for by-products.

IFRS 9, Financial Instruments ("IFRS 9")

The Company has adopted IFRS 9, *Financial Instruments*, with a date of initial application of January 1, 2018. IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities, and certain contracts to buy or sell non-financial items.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2018 and 2017

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

3. Significant accounting policies (continued)

(a) Changes to significant accounting policies

IFRS 9 replaces IAS 39, *Financial Instruments: Recognition and Measurement*, (“IAS 39”). It largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities.

IFRS 9 eliminates IAS 39 categories for financial assets of held to maturity, loans and receivables, and available for sale. The adoption of IFRS 9 has not had a significant effect on the Company’s accounting policies related to financial liabilities. The impact of IFRS 9 on the classification of financial assets is set out below.

Classification and measurement of financial assets

Under IFRS 9, on initial recognition, a financial asset is classified as either measured at amortized cost, fair value through other comprehensive income (“FVOCI”) – debt investment; FVOCI – equity investment; or fair value through profit and loss (“FVTPL”). This classification of a financial asset is based on the business model in which a financial asset is managed and its contractual cash flow characteristics.

A financial asset is measured at amortized cost if it meets both of the following conditions, and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Company does not currently have any debt or equity investments classified as measured at FVOCI.

All financial assets not measured at amortized cost or FVOCI are measured at FVTPL. This includes all derivative financial assets. On initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so reduces an accounting mismatch that would otherwise arise.

A financial asset not measured at FVTPL is initially measured at fair value plus transaction costs that are directly attributable to its acquisition. Trade and other receivables without a significant financing component are initially measured at the transaction price.

Financial assets at FVTPL: These assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income are recognized in net income.

Financial assets at amortized cost: These assets are subsequently measured at amortized cost using the effective interest rate method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses, and impairment are recognized in net income. Any gain or loss on derecognition is also recognized in net income.

The following table explains the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Company’s financial assets as at January 1, 2018.

	Original Classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	New carrying amount under IFRS 9
Forward exchange contracts	Designated as at fair value	Mandatorily at FVTPL	\$ 0.7	\$ 0.7
Investments	Held to maturity	Mandatorily at FVTPL	5.1	5.1
Cash and cash equivalents	Loans and receivables	Amortized cost	35.3	35.3
Trade and other receivables	Loans and receivables	Amortized cost	85.5	85.5
Total financial assets			\$ 126.6	\$ 126.6

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2018 and 2017

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

3. Significant accounting policies (continued)

(a) Changes to significant accounting policies (continued)

Impairment of financial assets

IFRS 9 also replaces the incurred loss model in IAS 39 with an expected credit loss (“ECL”) model. The new impairment model applies to financial assets measured at amortized costs, contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. The financial assets held at amortized cost consist of cash and cash equivalents and trade and other receivables.

Under IFRS 9, loss allowances are measured on either of 12 month ECLs where the ECLs result from all possible default events within the 12 months after the reporting date; or lifetime ECLs, where the ECLs result from all possible default events over the expected life of a financial instrument.

The Company measures loss allowances at an amount equal to 12 month ECLs for cash and cash equivalent balances where credit risk has not increased significantly since initial recognition. The Company has elected to measure loss allowances for trade receivables and any future contract assets at an amount equal to lifetime ECLs

Measurement of ECLs

ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all expected cash shortfalls and are discounted at the effective interest rate of the financial asset. At each reporting date the Company assesses whether financial assets carried at amortized costs are credit-impaired. A financial asset is considered credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Loss allowances for financial assets measured at amortized cost are deducted from the gross carrying amount of the assets. Impairment losses related to trade and other receivables, including contract assets, are presented separately in the statement of comprehensive income.

No adjustment to credit losses was required on adoption of IFRS 9.

(b) Standards and interpretations not yet adopted

IFRS 16, Leases (“IFRS 16”)

IFRS 16 is effective for years commencing on or after January 1, 2019, and will replace IAS 17, *Leases* (“IAS 17”). IFRS 16 provides a single lessee accounting model, requiring the recognition of assets and liabilities for all leases, unless the lease term is 12 months or less or the underlying asset has a low value, while lessor accounting remains largely unchanged from IAS 17 and the distinction between operating and finance leases is retained. 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.

4. Seasonality of operations

In a normal operating year, there is some seasonality to the Company’s operations, with higher lumber sales in the second and third quarters when construction activity in certain key markets 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 fires in the summer.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2018 and 2017

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

5. Inventory

	September 30, 2018	December 31, 2017
Gross value of inventory		
Logs	\$ 118.4	\$ 109.5
Lumber	60.6	36.8
Supplies and other	13.0	14.1
	<u>\$ 192.0</u>	<u>\$ 160.4</u>
Provisions		
Logs	\$ (6.7)	\$ (5.7)
Lumber	(6.6)	(2.2)
Supplies and other	(0.5)	(0.5)
	<u>\$ (13.8)</u>	<u>\$ (8.4)</u>
Total value of inventory	<u>\$ 178.2</u>	<u>\$ 152.0</u>

The carrying amount of inventory recorded at net realizable value was \$58.9 million at September 30, 2018 (December 31, 2017: \$51.3 million), with the remaining inventory recorded at cost.

During the three months ended September 30, 2018, \$229.3 million (2017: \$218.3 million) of inventory was charged to cost of goods sold, which includes an increase to the provision for write-down to net realizable value of \$3.8 million (2017: increase of \$0.8 million). During the nine months ended September 30, 2018, \$692.7 million (2017: \$652.3 million) of inventory was charged to cost of goods sold, which includes an increase to the provision for write-down to net realizable value of \$5.4 million (2017: decrease of \$2.8 million).

6. Property, plant and equipment

	Buildings & equipment	Logging roads	Land	Total
Cost				
Balance at January 1, 2017	\$ 302.8	\$ 178.4	\$ 90.6	\$ 571.8
Additions	41.7	13.5	-	55.2
Disposals	(2.6)	-	(2.8)	(5.4)
Balance at December 31, 2017	<u>341.9</u>	<u>191.9</u>	<u>87.8</u>	<u>621.6</u>
Additions	43.2	9.3	-	52.5
Arlington facility	7.9	-	3.7	11.6
Disposals	(5.9)	-	(0.9)	(6.8)
Balance at September 30, 2018	<u>\$ 387.1</u>	<u>\$ 201.2</u>	<u>\$ 90.6</u>	<u>\$ 678.9</u>
Accumulated amortization and impairments				
Balance at January 1, 2017	\$ 130.1	\$ 144.5	\$ -	\$ 274.6
Amortization	20.0	12.3	-	32.3
Disposals	(2.0)	-	-	(2.0)
Impairments	2.7	-	0.1	2.8
Balance at December 31, 2017	<u>150.8</u>	<u>156.8</u>	<u>0.1</u>	<u>307.7</u>
Amortization	17.0	10.3	-	27.3
Disposals	(5.9)	-	-	(5.9)
Impairments	0.1	-	0.2	0.3
Balance at September 30, 2018	<u>\$ 162.0</u>	<u>\$ 167.1</u>	<u>\$ 0.3</u>	<u>\$ 329.4</u>
Carrying amounts				
At December 31, 2017	\$ 191.1	\$ 35.1	\$ 87.7	\$ 313.9
At September 30, 2018	<u>\$ 225.1</u>	<u>\$ 34.1</u>	<u>\$ 90.3</u>	<u>\$ 349.5</u>

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2018 and 2017

(Tabular amounts expressed in millions of Canadian dollars except number of shares and per share amounts)

7. Biological assets

(a) Reconciliation of carrying amount

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Carrying value, beginning of period	\$ 57.9	\$ 56.1	\$ 58.2	\$ 57.6
Change in fair value due to growth and pricing	1.4	1.4	4.2	4.2
Harvested timber transferred to inventory	(0.6)	-	(3.7)	(4.3)
Carrying value, end of period	\$ 58.7	\$ 57.5	\$ 58.7	\$ 57.5

Under IAS 41, *Agriculture*, the Company's private timberlands are classified as a growing forest, with the standing timber recorded as a biological asset at fair value less costs to sell at each reporting date.

The land underlying the standing timber is considered a component of property, plant and equipment, and is recorded at cost less accumulated impairment. Roads and bridges on the land underlying the standing timber are considered a component of property, plant and equipment and are recorded at cost less accumulated amortization.

At September 30, 2018, private timberlands comprised an area of approximately 23,293 hectares (December 31, 2017: 23,293 hectares) of land owned by the Company; standing timber on these timberlands ranged from newly planted cut-blocks to mature forest available for harvest. During the three and nine months ended September 30, 2018, the Company harvested and scaled approximately 13,525 cubic metres ("m³") and 95,399 m³, respectively of logs from its private timberlands, (2017: 1,107 m³ and 111,571 m³, respectively), which had a fair value less costs to sell of \$107 per m³ and \$102 per m³, respectively at the date of harvest (2017: \$112 per m³ and \$113 per m³, respectively).

The financial risks associated with standing timber are mitigated by the geographical diversification of the asset and management strategies including fire management strategies and regular inspection for pest infestation.

(b) Measurement of fair values

The fair value measurement for the Company's standing timber of \$58.7 million, is measured at fair value less costs to sell. The valuation technique used is discounted cash flows combined with market comparison.

At each interim reporting date, the Company examines market and asset conditions to determine if changing conditions would yield a change in fair value less costs to sell. The Company reviewed the underlying assumptions impacting its standing timber as at September 30, 2018 and noted no indication that a full re-assessment of fair value less costs to sell, or of the previously applied significant unobservable inputs, was warranted at that date.

The change in fair value resulting from price and growth is reflected in cost of goods sold.

8. Long term debt

	September 30, 2018	December 31, 2017
Available	\$ 250.0	\$ 110.0
Drawings	-	-
Outstanding letters of credit	1.0	-
Unused portion of Credit Facility	\$ 249.0	\$ 110.0

On August 8, 2018, the Company entered into a new syndicated Credit Facility (the "Credit Facility"). The Credit Facility provides for a maximum borrowing amount of \$250 million, has a maturity date of August 1, 2022, and includes an accordion feature which allows the Company to increase the aggregate amount available to \$350 million, subject to lender approval.

The Credit Facility is available in Canadian dollars by way of Prime Rate Advances, Bankers' Acceptances or Letters of Credit and in US dollars by way of US Base Rate Advances, US Prime Rate Advances, LIBOR Advances or Letters of Credit. Interest on the Credit Facility is indexed to benchmark rates and varies depending on the nature of each draw and a total debt to EBITDA based pricing grid.

Western Forest Products Inc.

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8. Long term debt (continued)

The Credit Facility is secured by a general security agreement, excluding specified properties and their related assets, and is subject to certain financial covenants, including maximum debt to total capitalization ratios.

At September 30, 2018, there were no amounts outstanding under the Company's Credit Facility and as a result, the associated deferred transaction costs of \$1.0 million are included in other assets on the statement of financial position. The Company was in compliance with its financial covenants at September 30, 2018.

9. Income taxes

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Current income tax expense	\$ (6.2)	\$ (0.1)	\$ (14.3)	\$ (0.2)
Deferred income tax recovery (expense)	0.5	(4.1)	(10.1)	(18.5)
	<u>\$ (5.7)</u>	<u>\$ (4.2)</u>	<u>\$ (24.4)</u>	<u>\$ (18.7)</u>

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Income before income taxes	\$ 20.8	\$ 17.8	\$ 88.3	\$ 74.1
Income tax expense at statutory rate of 27% (2017 - 26%)	(5.6)	(4.6)	(23.8)	(19.3)
Permanent differences	(0.1)	0.4	(0.6)	0.6
	<u>\$ (5.7)</u>	<u>\$ (4.2)</u>	<u>\$ (24.4)</u>	<u>\$ (18.7)</u>

In addition to the amounts recorded to net income, a deferred tax expense of \$0.5 million and \$0.3 million were recorded to other comprehensive income for the three and nine month periods ended September 30, 2018, respectively (2017: expense of \$0.7 million and \$0.2 million, respectively) in relation to current period actuarial gains on defined benefit employee future benefit obligations.

10. Reforestation obligation

The Company has a responsibility to reforest timber harvested under various timber rights. Changes in the reforestation obligation are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Reforestation obligation, beginning of period	\$ 24.7	\$ 25.9	\$ 25.3	\$ 28.9
Reforestation provision charged	1.8	1.6	5.9	3.4
Reforestation expenditures	(2.1)	(2.8)	(7.0)	(7.7)
Unwind of discount	-	0.1	0.2	0.2
Reforestation obligation, end of period	<u>24.4</u>	<u>24.8</u>	<u>24.4</u>	<u>24.8</u>
Less current portion	9.9	9.2	9.9	9.2
	<u>\$ 14.5</u>	<u>\$ 15.6</u>	<u>\$ 14.5</u>	<u>\$ 15.6</u>

The reforestation expenditures are expected to occur over the next one to ten years and have been discounted at risk-free rates of 2.04% to 2.43%. The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at September 30, 2018 is \$26.0 million (December 31, 2017: \$26.7 million). Reforestation expense incurred on current production is included in production costs and the unwinding of discount, or accretion cost, is included in finance costs for the period.

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11. Other liabilities

	September 30, 2018	December 31, 2017
Employee future benefits obligation ^(Note 14)	\$ 18.1	\$ 21.4
Environmental accruals	1.5	3.1
Performance share unit plan liabilities, non-current ^{(Note 12(d))}	1.7	2.5
Other	1.4	1.2
	<u>\$ 22.7</u>	<u>\$ 28.2</u>

12. Share capital

(a) Issued and outstanding share capital

	Number of Common Shares	Amount
Balance at December 31, 2017	394,776,092	\$ 505.5
Exercise of stock options	660,000	0.6
Repurchase of shares	(6,779,705)	(8.7)
Balance at September 30, 2018	<u>388,656,387</u>	<u>\$ 497.4</u>

(b) Stock option plan

The Company has an incentive stock option plan (the "Option Plan"), which permits the granting of options to eligible participants to purchase up to an aggregate of 30,000,000 Common Shares.

Each option is exercisable, subject to vesting terms of 20% per year and immediately upon a change in control of the Company, into one Common Share, subject to adjustments, at a price of not less than the closing price of the Common Shares on the TSX on the day immediately preceding the grant date. Options granted under the Option Plan expire a maximum of ten years from the date of the grant. All outstanding options are only exercisable when the share price has been equal to or exceeds \$0.70 for the 60 consecutive days preceding the date of exercise on a volume weighted average price basis.

During the first quarter of 2018, the Company granted 1,235,788 options with a fair value of \$0.9 million as determined by the Black-Scholes option pricing model, using the assumptions of an average exercise price of \$2.74 per share, risk free interest rate of 2.28%, a volatility rate of 33.81%, and an expected life of seven years. At September 30, 2018, 12,294,271 options (December 31, 2017: 11,718,483) were outstanding under the Company's Option Plan, with a weighted average exercise price of \$1.73 per share.

	Nine months ended September 30, 2018		Nine months ended September 30, 2017	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Outstanding, beginning of period	11,718,483	\$ 1.56	11,235,585	\$ 1.50
Granted	1,235,788	\$ 2.74	1,657,877	\$ 2.09
Exercised	(660,000)	\$ 0.59	(426,226)	\$ 1.40
Forfeited	-	\$ -	(748,753)	\$ 1.99
Outstanding, end of period	<u>12,294,271</u>	<u>\$ 1.73</u>	<u>11,718,483</u>	<u>\$ 1.56</u>

During the three and nine months ended September 30, 2018, the Company recorded a compensation expense for these stock options of \$0.2 million and \$0.6 million, respectively (2017: recovery of \$0.3 million and expense of \$0.2 million, respectively).

(c) Deferred share unit ("DSU") plan

The Company has a DSU Plan for directors and designated executive officers. Directors may elect to take a portion of their fees in the form of DSUs and prior to January 1, 2015 executive officers could elect to take a portion of their annual incentive bonus in the form of DSUs. For directors, the number of DSUs allotted is determined by dividing the dollar portion of the quarterly fees a director elects to take in DSUs by the closing share price on the fifth day following each quarter end. All DSU holders are entitled to DSU dividends, equivalent to the dividend they would have received if they held their DSUs as common shares.

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12. Share capital (continued)

(c) Deferred share unit ("DSU") plan (continued)

For dividends, the number of DSUs allotted is determined by dividing the total dollar value of the dividend each DSU holder would have received, by the closing share price on the dividend payment date.

Effective January 1, 2015, DSUs are only granted to non-executive directors per the amended DSU Plan.

	Nine months ended September 30, 2018		Nine months ended September 30, 2017	
	Number of DSU	Weighted average unit value	Number of DSU	Weighted average unit value
Outstanding, beginning of period	1,282,219	\$ 1.18	1,100,073	\$ 0.98
Granted	130,534	\$ 2.50	138,410	\$ 2.34
Outstanding, end of period	1,412,753	\$ 1.30	1,238,483	\$ 1.13

During the three and nine months ended September 30, 2018, the Company recorded a compensation recovery of \$0.7 million and expense of \$0.4 million for these DSUs, respectively (2017: expense of \$0.5 million and \$1.2 million, respectively), with corresponding adjustments to accounts payable and accrued liabilities.

(d) Performance share unit ("PSU") plan

The Company has established a PSU Plan for designated officers and employees of the Company. Under the terms of the PSU Plan, participants are granted a number of PSUs based on a target award divided by the closing value of the Company's Common Shares on the trading day immediately preceding the grant date. All PSU holders are entitled to PSU dividends, equivalent to the dividend they would have received if they held their PSUs as common shares.

Performance targets are set by the Management Resource & Compensation Committee of the Company's Board of Directors. The number of PSUs which will ultimately vest will be the original number of PSUs granted plus PSUs equal to the value of accrued notional dividends over the performance period. For dividends, the number of PSUs allotted is determined by dividing the total dollar value of the dividend each PSU holder would have received, by the closing share price on the trading day immediately after the dividend date of record. The redemption value of vested PSUs will be in a range from 0% to 200% based on return on capital employed over a three year performance period.

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Outstanding, beginning of period	1,678,522	1,557,856	1,582,285	952,236
Granted	16,850	11,881	542,089	617,501
Redeemed	-	-	(429,002)	-
Outstanding, end of period	1,695,372	1,569,737	1,695,372	1,569,737

During the three months and nine months ended September 30, 2018, the Company recorded a compensation recovery for these PSUs of \$0.5 million and expense of \$1.2 million, respectively (2017: expense of \$1.0 million and \$2.7 million, respectively), with corresponding adjustments to accounts payable and accrued liabilities and other liabilities.

13. Commitments and contingencies

Long-term fibre supply agreements

Certain of the Company's long term fibre supply agreements with third parties have minimum volume requirements and may, in the case of a failure to produce the minimum annual volume, require the Company to conduct whole log chipping or sell saw logs, which could reduce log availability for our sawmills, source the deficiency from third parties at additional cost to the Company or pay the party to the fibre supply agreement a penalty calculated based on the provisions contained in the relevant agreement.

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13. Commitments and contingencies (continued)

Long-term fibre supply agreements (continued)

Should Western take significant market related curtailments in its sawmills, the volume of chips produced is reduced and accordingly there is greater risk that the Company may not meet its contractual obligations, if it is not possible to secure replacement chips on the open market during that period.

Based on chip and pulp log volumes supplied year-to-date, the Company anticipates satisfying annual fibre commitments for 2018.

Litigations and claims

In the normal course of its business activities, the Company may be subject to a number of claims and legal actions that may be made by customers, unions, suppliers and others in respect of which either provision has been made or for which no material liability is expected. Where the Company is not able to determine the outcome of these disputes no amounts have been accrued in these financial statements

Key dates in the softwood lumber duty dispute

Under the softwood lumber agreement ("SLA") between Canada and the United States ("US"), the Company's exports to the US were assessed an export tax by the Canadian Government. The SLA expired on October 12, 2015, eliminating export tax measures on Canadian softwood lumber shipments to the US.

Throughout 2016 and 2017 there were several announcements made by US Department of Commerce ("DoC") and the US International Trade Commission ("ITC") outlining rates on Countervailing ("CVD") and Anti-dumping duties ("AD") on Canadian softwood lumber shipments to the US. The Company disclosed these in its audited annual consolidated financial statements for the year ended December 31, 2017.

On January 3, 2018, the DoC 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.

Lumber duties and export tax

Cash deposits for CVD were required for lumber imports to the US effective April 28, 2017 through August 25, 2017, after which they were not applicable pending the ITC's final CVD determination. Cash deposits for CVD resumed on publication of ITC final affirmative CVD determination in the US Federal Register on December 28, 2017.

Cash deposits for AD were required for lumber imports to the US effective June 30, 2017 until December 26, 2017, and resumed on publication of the ITC final affirmative injury determination on December 28, 2017. The Company recorded an export tax recovery of \$3.6 million arising from the difference between export duties paid at preliminary determination rates and the latest final duty rates, in the fourth quarter of 2017. A corresponding increase was recognized in other assets in the consolidated statement of financial position.

Incremental export duty recoveries from any future change in CVD and AD rates will be netted against export tax expense and included in other assets.

As at September 30, 2018, the balance of CVD and AD deposits was \$50.3 million.

Tax correspondence

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 at September 30, 2018 relating to this matter.

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14. Employee future benefits

The amounts recognized in the statement of financial position for the Company's employee future benefit obligations, consisting of both the defined benefit salaried pension plans and other non-pension benefits are as follows:

	September 30, 2018	December 31, 2017
Present value of obligations	\$ 127.4	\$ 133.9
Fair value of plan assets	(109.3)	(112.5)
Liability recognized in the statement of financial position ^(Note 11)	<u>\$ 18.1</u>	<u>\$ 21.4</u>

The change in the liability recognized in the statement of financial position at September 30, 2018 was due primarily to contributions and actuarial gains from which quarterly changes in the discount rate used to value the defined benefit obligation, offset by actuarial losses resulted from lower than expected return on plan assets. The discount rate used as at September 30, 2018 was 3.60% per annum (December 31, 2017: 3.35% per annum).

The Company expects to make funding contributions to its defined benefit plans of \$3.1 million during 2018.

15. Financial instruments – fair values

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair valuation hierarchy. It does not include fair value information for financial assets or liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value. The Company's investments and foreign currency forward contracts continue to be measured based on Level 2 of the fair value hierarchy.

	September 30, 2018			December 31, 2017		
	Mandatory at at FVTPL	Amortized Cost	Total	Mandatory at FVTPL	Amortized Cost	Total
Financial assets						
Investments	\$ 5.0	\$ -	\$ 5.0	\$ 5.1	\$ -	\$ 5.1
Foreign currency forward contracts	1.0	-	1.0	0.7	-	0.7
Cash and cash equivalents	-	42.8	42.8	-	35.3	35.3
Trade and other receivables	-	87.6	87.6	-	85.5	85.5
Total financial assets	<u>\$ 6.0</u>	<u>\$ 130.4</u>	<u>\$ 136.4</u>	<u>\$ 5.8</u>	<u>\$ 120.8</u>	<u>\$ 126.6</u>
	Mandatory at FVTPL	Other Financial Liabilities	Total	Mandatory at FVTPL	Other Financial Liabilities	Total
Financial liabilities						
Accounts payable and accrued liabilities	\$ -	\$ 136.1	\$ 136.1	\$ -	\$ 98.9	\$ 98.9
Total financial liabilities	<u>\$ -</u>	<u>\$ 136.1</u>	<u>\$ 136.1</u>	<u>\$ -</u>	<u>\$ 98.9</u>	<u>\$ 98.9</u>

As at September 30, 2018, the Company had outstanding obligations to sell an aggregate Japanese Yen ("JPY") 100.0 million at an average rate of JPY 87.07 per Canadian Dollar ("CAD") with maturities through October 15, 2018, and an aggregate US Dollar ("USD") \$50.0 million at an average rate of CAD\$1.31 per USD with maturities through November 29, 2018.

All foreign currency gains or losses related to currency forward contracts to September 30, 2018 have been recognized in revenue for the period. The fair value of these instruments at September 30, 2018 was a net asset of \$1.0 million, which is included in trade and other receivables on the statement of financial position (December 31, 2017: net asset of \$0.7 million). A net loss of \$3.2 million was recognized on contracts which were settled in the nine months ended September 30, 2018 (2017: net gain of \$4.2 million), which was included in revenue for the period.

16. Operating restructuring items

Included in the operating restructuring expense in the third quarter of 2018 is \$0.9 million of incremental costs associated with the closure of the Company's former Nanaimo sawmill and \$0.5 million of non-operating costs pertaining to the indefinite curtailment of the Company's Somass sawmill. The Company announced the indefinite curtailment of the Somass sawmill, located in Port Alberni, BC, on July 27, 2017.

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17. Revenue

Disaggregation of revenue

In the following table, revenue is disaggregated by primary geographical market, based on the known origin of the customer, and by major products.

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Primary geographical markets				
Canada	\$ 105.5	\$ 88.4	\$ 342.8	\$ 267.8
United States	74.6	62.3	224.2	224.3
China	48.1	68.7	141.8	170.6
Japan	33.5	38.7	115.5	111.0
Other	27.2	19.5	76.6	63.4
Europe	3.6	7.6	11.0	23.2
	<u>\$ 292.5</u>	<u>\$ 285.2</u>	<u>\$ 911.9</u>	<u>\$ 860.3</u>
Major Products				
Lumber	\$ 238.2	\$ 212.5	\$ 722.0	\$ 650.9
Logs	33.6	55.5	123.8	158.2
By-products	20.7	17.2	66.1	51.2
	<u>\$ 292.5</u>	<u>\$ 285.2</u>	<u>\$ 911.9</u>	<u>\$ 860.3</u>

Contract balances

The following table provides information about receivables and contract liabilities from contracts with customers.

	September 30,	
	2018	2017
Receivables	\$ 88.6	\$ 87.3
Contract liabilities	<u>54.9</u>	<u>56.9</u>

The contract liabilities relate to the consideration received from a customer for a long-term fibre supply contract and are recognized as deferred revenue, for which revenue is recognized straight-line over the term of the contract. The contract liabilities decreased \$1.5 million during the nine months ended September 30, 2018 as the amount was recognized as revenue.

Contract costs

The Company will capitalize costs to obtain contracts and amortize fees when related revenues are recognized, where the amortization period is greater than one year.



Western Forest Products Inc.

DEFINING A HIGHER STANDARD™

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