



Western Forest Products Inc.

Unaudited Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2019 and 2018

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

	September 30, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 5.1	\$ 8.4
Trade and other receivables ^(Note 16)	31.4	91.3
Inventory ^(Note 5)	150.4	174.9
Prepaid expenses and other assets	22.3	23.3
Income taxes receivable	13.2	-
	<u>222.4</u>	<u>297.9</u>
Non-current assets:		
Property, plant and equipment ^(Note 6)	431.6	369.9
Timber licenses	110.1	113.2
Biological assets ^(Note 7)	57.4	58.3
Other assets	17.0	15.8
Deferred income tax assets	0.9	0.7
	<u>\$ 839.4</u>	<u>\$ 855.8</u>
Liabilities and Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 43.6	\$ 119.2
Income taxes payable	-	13.5
Current portion of lease liability ^(Note 3)	5.4	-
Reforestation obligation ^(Note 10)	8.8	10.0
	<u>57.8</u>	<u>142.7</u>
Non-current liabilities:		
Long-term debt ^(Note 8)	112.0	6.0
Long-term lease liability ^(Note 3)	17.2	-
Reforestation obligation ^(Note 10)	14.3	15.7
Deferred income tax liabilities	43.8	40.3
Other liabilities ^(Note 11)	21.3	23.8
Deferred revenue	52.9	54.4
	<u>319.3</u>	<u>282.9</u>
Equity:		
Share capital ^{(Note 12(a))}	479.9	491.1
Contributed surplus	9.5	9.1
Translation reserve	0.3	-
Retained earnings	29.4	72.7
Total equity attributable to equity shareholders of the Company	<u>519.1</u>	<u>572.9</u>
Non-controlling interest ^(Note 17)	1.0	-
	<u>520.1</u>	<u>572.9</u>
	<u>\$ 839.4</u>	<u>\$ 855.8</u>

Commitments and Contingencies ^(Note 13)

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

Approved on behalf of the Board:

"Michael T. Waites"

Chair

"Don Demens"

President and CEO

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

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Revenue ^(Note 16)	\$ 141.6	\$ 292.5	\$ 727.6	\$ 911.9
Costs and expenses:				
Cost of goods sold	144.8	229.3	638.2	692.7
Freight	9.5	21.8	59.0	66.2
Export tax ^(Note 13)	5.5	11.5	24.4	32.9
Selling and administration	6.0	6.5	23.1	24.4
	<u>165.8</u>	<u>269.1</u>	<u>744.7</u>	<u>816.2</u>
Operating income (loss) prior to restructuring and other items	<u>(24.2)</u>	<u>23.4</u>	<u>(17.1)</u>	<u>95.7</u>
Operating restructuring items	(0.3)	(1.7)	(1.4)	(5.2)
Other income (expense)	0.7	-	(0.1)	(0.2)
Operating income (loss)	<u>(23.8)</u>	<u>21.7</u>	<u>(18.6)</u>	<u>90.3</u>
Finance costs	(1.9)	(0.9)	(5.6)	(2.0)
Income (loss) before income taxes	<u>(25.7)</u>	<u>20.8</u>	<u>(24.2)</u>	<u>88.3</u>
Current income tax recovery (expense) ^(Note 9)	9.6	(6.2)	9.6	(14.3)
Deferred income tax recovery (expense) ^(Note 9)	(2.6)	0.5	(2.9)	(10.1)
	<u>7.0</u>	<u>(5.7)</u>	<u>6.7</u>	<u>(24.4)</u>
Net income (loss)	<u>(18.7)</u>	<u>15.1</u>	<u>(17.5)</u>	<u>63.9</u>
Net income (loss) attributable to equity shareholders of the Company	(18.7)	15.1	(17.3)	63.9
Net income (loss) attributable to non-controlling interest ^(Note 17)	-	-	(0.2)	-
	<u>(18.7)</u>	<u>15.1</u>	<u>(17.5)</u>	<u>63.9</u>
Other comprehensive income (loss)				
Items that will not be reclassified to profit or loss:				
Defined benefit plan actuarial gain (loss) ^(Note 14)	0.4	1.9	(0.9)	1.0
Income tax (expense) recovery on other comprehensive gain (loss) ^(Note 9)	(0.1)	(0.5)	0.3	(0.3)
Total items that will not be reclassified to profit or loss	<u>0.3</u>	<u>1.4</u>	<u>(0.6)</u>	<u>0.7</u>
Items that may be reclassified subsequently to profit or loss:				
Foreign exchange translation of foreign operations	<u>0.7</u>	<u>-</u>	<u>0.3</u>	<u>-</u>
Total comprehensive income (loss)	<u>\$ (17.7)</u>	<u>\$ 16.5</u>	<u>\$ (17.8)</u>	<u>\$ 64.6</u>
Net income per share (in dollars)				
Basic and diluted earnings per share	\$ (0.05)	\$ 0.04	\$ (0.05)	\$ 0.16
Weighted average number of common shares outstanding (thousands)				
Basic	375,428	392,194	378,450	393,945
Diluted	376,509	395,904	380,217	398,171

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

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

	Share Capital	Contributed Surplus	Translation Reserve	Retained Earnings	Non- controlling Interest	Total Equity
Balance at December 31, 2017	\$ 505.5	\$ 8.7	\$ -	\$ 48.5	\$ -	\$ 562.7
Net income	-	-	-	63.9	-	63.9
Other comprehensive income:						
Defined benefit plan actuarial gain recognized	-	-	-	1.0	-	1.0
Income tax expense on other comprehensive income	-	-	-	(0.3)	-	(0.3)
Total comprehensive income	-	-	-	64.6	-	64.6
Share-based payment transactions recognized in equity	-	0.6	-	-	-	0.6
Exercise of stock options	0.6	(0.2)	-	-	-	0.4
Repurchase of shares	(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
Balance at December 31, 2018	\$ 491.1	\$ 9.1	\$ -	\$ 72.7	\$ -	\$ 572.9
Net loss	-	-	-	(17.3)	(0.2)	(17.5)
Other comprehensive loss:						
Defined benefit plan actuarial loss recognized	-	-	-	(0.9)	-	(0.9)
Income tax recovery on other comprehensive loss	-	-	-	0.3	-	0.3
Foreign exchange translation of foreign operations	-	-	0.3	-	-	0.3
Total comprehensive income (loss)	-	-	0.3	(17.9)	(0.2)	(17.8)
Share-based payment transactions recognized in equity ^{(Note 12(b))}	-	0.5	-	-	-	0.5
Non-controlling interest ^(Note 17)	-	-	-	5.0	1.2	6.2
Exercise of stock options ^{(Note 12(a))}	0.1	(0.1)	-	-	-	-
Repurchase of shares ^{(Note 12(a))}	(11.3)	-	-	(4.9)	-	(16.2)
Dividends	-	-	-	(25.5)	-	(25.5)
Total transactions with owners, recorded directly in equity	(11.2)	0.4	-	(25.4)	1.2	(35.0)
Balance at September 30, 2019	\$ 479.9	\$ 9.5	\$ 0.3	\$ 29.4	\$ 1.0	\$ 520.1

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,	
	2019	2018	2019	2018
Cash provided by (used in):				
Operating activities:				
Net income (loss)	\$ (18.7)	\$ 15.1	\$ (17.5)	\$ 63.9
Items not involving cash:				
Amortization of property, plant and equipment ^(Note 6)	8.2	8.7	30.0	27.3
Amortization of timber licenses	1.0	0.9	3.0	3.0
Gain on disposal of assets	(0.4)	-	(0.5)	(0.3)
Change in fair value of biological assets ^(Note 7)	(1.4)	(0.8)	0.9	(0.5)
Change in reforestation obligation ^(Note 10)	(2.2)	(0.3)	(2.5)	(0.9)
Amortization of deferred revenue	(0.5)	(0.5)	(1.5)	(1.5)
Share-based compensation, including mark-to-market adjustment	(1.0)	(1.0)	(1.2)	1.7
Net finance costs	1.9	0.9	5.6	2.0
Income tax (recovery) expense ^(Note 9)	(7.0)	5.7	(6.7)	24.4
Change in pension liability ^(Note 14)	(0.4)	(0.7)	(2.2)	(2.3)
Export tax receivable	(0.2)	-	0.1	-
Other	(1.3)	0.1	(1.9)	0.3
Income taxes received (paid)	6.1	(2.2)	(17.0)	(2.2)
	<u>(15.9)</u>	<u>25.9</u>	<u>(11.4)</u>	<u>114.9</u>
Changes in non-cash working capital items:				
Trade and other receivables	68.1	5.5	60.5	(2.4)
Inventory	62.6	14.0	31.2	(26.2)
Prepaid expenses and other assets	(5.7)	2.1	4.4	4.0
Accounts payable and accrued liabilities	(86.8)	(7.4)	(81.0)	22.3
	<u>38.2</u>	<u>14.2</u>	<u>15.1</u>	<u>(2.3)</u>
	<u>22.3</u>	<u>40.1</u>	<u>3.7</u>	<u>112.6</u>
Investing activities:				
Additions to property, plant and equipment ^(Note 6)	(3.7)	(20.7)	(35.6)	(52.5)
Purchase of Arlington facility	-	-	-	(11.6)
Purchase of Columbia Vista ^(Note 18)	-	-	(37.7)	-
Proceeds on disposal of assets	1.5	0.8	2.3	1.1
Proceeds from disposition of minority interest in subsidiary, net ^(Note 17)	0.8	-	7.0	-
	<u>(1.4)</u>	<u>(19.9)</u>	<u>(64.0)</u>	<u>(63.0)</u>
Financing activities:				
Interest paid	(2.2)	(0.3)	(4.2)	(0.8)
Draw on (repayment of) long-term debt ^(Note 8)	(7.5)	-	105.8	-
Payment of lease liabilities	(1.1)	-	(2.8)	-
Repurchase of shares ^{(Note 12(a))}	(1.9)	(10.4)	(15.9)	(16.1)
Dividends	(8.4)	(8.8)	(25.5)	(25.6)
Proceeds from exercise of stock options, net ^{(Note 12(b))}	-	-	(0.4)	0.4
	<u>(21.1)</u>	<u>(19.5)</u>	<u>57.0</u>	<u>(42.1)</u>
Increase (decrease) in cash and cash equivalents	(0.2)	0.7	(3.3)	7.5
Cash and cash equivalents, beginning of period	5.3	42.1	8.4	35.3
Cash and cash equivalents, end of period	<u>\$ 5.1</u>	<u>\$ 42.8</u>	<u>\$ 5.1</u>	<u>\$ 42.8</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, 2019 and 2018

(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, Canada. The unaudited condensed consolidated interim financial statements as at and for the three and nine months ended September 30, 2019 and 2018 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 ("TSX"), 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 International Accounting Standards ("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, 2018. 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 6, 2019.

(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, 2018, except for new significant judgements related to the lessee accounting under IFRS 16, *Leases*, which are described in Note 3.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2019 and 2018

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

3. Significant accounting policies

Except as described below and in Note 18, 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, 2018.

Changes to significant accounting policies

IFRS 16, Leases ("IFRS 16")

The Company adopted IFRS 16, with a date of initial application of January 1, 2019, using a modified retrospective approach, whereby the cumulative effect of initially applying the standard was recognized with no adjustment to retained earnings at January 1, 2019. The comparative information presented for 2018 has not been restated and continues to be reported under IAS 17, *Leases*, ("IAS 17") and related interpretations.

Lease definition

When a contract is entered into, the Company will assess if a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A contract will convey the right to control the use of an identified asset for a period of time if the Company has the right to obtain substantially all of the economic benefits from use of the identified asset and the right to direct the use of the identified asset.

This policy is applied to contracts entered into, or changed, on or after January 1, 2019.

Measurement of right of use assets and lease liabilities

The Company recognizes a right of use asset and lease liability at the lease commencement date. At this date, the right of use asset is measured at cost. Cost includes the initial amount of the lease liability, adjusted for lease payments made before this date plus initial direct costs incurred, less any lease incentives received.

The right of use asset is depreciated using the straight-line method from the lease commencement date to the earlier of the end of the lease term or the end of the useful life of the right of use asset. The estimated useful lives of right of use assets are determined in the same manner as those of property plant and equipment. Right of use assets are adjusted for impairments and/or re-measurements of the lease liability.

At the lease commencement date, the lease liability is measured at the present value of the future lease payments. The lease payments are discounted using the interest rate implicit in the lease, or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

Lease payments included in the measurement of the lease liability consist of fixed payments, including in-substance fixed payments, variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date, the expected amounts payable under residual value guarantees, the exercise price of a purchase option that the Company is reasonably certain to exercise, and penalties for terminating the lease, if the lease term reflects the lessee exercising an early termination option.

Subsequent to initial measurement, the lease liability is measured at amortized cost using the effective interest method. The lease liability is re-measured when there is a change in future lease payments due to a change in an index or rate, a change in the Company's estimate of an amount payable under residual value guarantee, or if there is a change in the assessment of whether the Company will exercise a purchase, termination or extension option. When the lease liability is re-measured, a corresponding adjustment is made to the right of use asset.

The Company presents right of use assets in property, plant and equipment and lease liabilities separately on the statement of financial position.

The Company elected not to recognize right of use assets and corresponding lease liabilities for leases with a term of 12 months or less and low value leases, including office fixtures, information technology equipment and small manufacturing and storage equipment. The Company recognizes these lease payments as an expense on a straight-line basis over the term of the lease.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2019 and 2018

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

3. Significant accounting policies (continued)

Changes to significant accounting policies

IFRS 16, Leases ("IFRS 16") - At adoption

On adoption of IFRS 16, the Company recognized right of use assets (included in "Property, plant & equipment") with a corresponding increase to lease liabilities. To measure lease liabilities for leases that were classified as operating leases under IAS 17, the Company discounted the future lease payments using its incremental borrowing rate at adoption. The weighted average incremental borrowing rate used to determine the lease obligation at adoption was approximately 4.5%.

	Buildings & Equipment		Land		Total
Balance as at January 1, 2019	\$	7.7	\$	9.3	\$ 17.0
Balance as at September 30, 2019	\$	13.2	\$	8.8	\$ 22.0

In its annual consolidated financial statements as at and for the year ended December 31, 2018, the Company disclosed \$19.7 million of operating lease commitments. These, discounted at the incremental borrowing rate as at January 1, 2019, resulted in an opening lease liability of \$17.0 million. In the three and nine months ended September 30, 2019, the Company recognized an expense of \$0.3 million and \$0.8 million, respectively, relating to short term and low value lease payments that were previously treated as rental agreements. In the three and nine months ended September 30, 2019, the Company recognized amortization of \$1.5 million and \$3.3 million, respectively, related to its right of use assets. Interest expense on lease liabilities for the three and nine months ended September 30, 2019 was \$0.6 million and \$2.3 million, respectively.

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.

5. Inventory

	September 30, 2019	December 31, 2018
Gross value of inventory		
Logs	\$ 113.0	\$ 125.7
Lumber	37.9	51.7
Supplies and other	15.5	13.1
	<u>\$ 166.4</u>	<u>\$ 190.5</u>
Provisions		
Logs	\$ (9.4)	\$ (8.8)
Lumber	(6.2)	(6.3)
Supplies and other	(0.4)	(0.5)
	<u>\$ (16.0)</u>	<u>\$ (15.6)</u>
Total value of inventory	<u>\$ 150.4</u>	<u>\$ 174.9</u>

The carrying amount of inventory recorded at net realizable value was \$59.8 million at September 30, 2019 (December 31, 2018: \$79.4 million), with the remaining inventory recorded at cost.

During the three and nine months ended September 30, 2019, \$144.8 million and \$638.2 million, respectively (2018: \$229.3 million and \$692.7 million, respectively) of inventory was charged to cost of goods sold. This includes a decrease to the net realizable value provision of \$1.6 million for the three months ended September 30, 2019, and an increase of \$0.4 million for the nine months ended September 30, 2019 (2018: increase of \$3.8 million and \$5.4 million, respectively).

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2019 and 2018

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

6. Property, plant and equipment

Cost	Buildings & equipment	Logging roads	Land	Right of use assets	Total
Balance at January 1, 2018	\$ 341.9	\$ 191.9	\$ 87.8	\$ -	\$ 621.6
Additions	70.6	12.9	-	-	83.5
Arlington facility	7.9	-	3.7	-	11.6
Disposals	(6.7)	-	(2.3)	-	(9.0)
Balance at December 31, 2018	413.7	204.8	89.2	-	707.7
Adoption of IFRS 16	-	-	-	17.0	17.0
Additions	25.4	10.2	-	7.5	43.1
Columbia Vista assets (Note 18)	21.0	-	10.6	0.8	32.4
Disposals	(0.9)	-	(1.6)	-	(2.5)
Effect of movements in exchange rates	0.7	-	0.3	-	1.0
Balance at September 30, 2019	\$ 459.9	\$ 215.0	\$ 98.5	\$ 25.3	\$ 798.7
Accumulated amortization and impairments					
Balance at January 1, 2018	\$ 150.8	\$ 156.8	\$ 0.1	\$ -	\$ 307.7
Amortization	23.0	13.2	-	-	36.2
Disposals	(6.4)	-	-	-	(6.4)
Impairments	0.1	-	0.2	-	0.3
Balance at December 31, 2018	167.5	170.0	0.3	-	337.8
Amortization	18.9	7.8	-	3.3	30.0
Disposals	(0.7)	-	-	-	(0.7)
Balance at September 30, 2019	\$ 185.7	\$ 177.8	\$ 0.3	\$ 3.3	\$ 367.1
Carrying amounts					
At December 31, 2018	\$ 246.2	\$ 34.8	\$ 88.9	\$ -	\$ 369.9
At September 30, 2019	\$ 274.2	\$ 37.2	\$ 98.2	\$ 22.0	\$ 431.6

7. Biological assets

(a) Reconciliation of carrying amount

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Carrying value, beginning of period	\$ 56.0	\$ 57.9	\$ 58.3	\$ 58.2
Change in fair value due to growth and pricing	1.4	1.4	4.2	4.2
Harvested timber transferred to inventory	-	(0.6)	(5.1)	(3.7)
Carrying value, end of period	\$ 57.4	\$ 58.7	\$ 57.4	\$ 58.7

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, 2019, private timberlands comprised an area of approximately 23,293 hectares (December 31, 2018: 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 months ended September 30, 2019, the Company had no harvesting activities, and for the nine months ended September 30, 2019, the Company harvested and scaled approximately 132,897 cubic metres ("m³") of logs (2018: 13,525 m³ and 95,399 m³, respectively), which had a fair value less costs to sell of \$115 per m³ at the date of harvest (2018: \$107 per m³ and \$102 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.

Western Forest Products Inc.

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

Three and nine months ended September 30, 2019 and 2018

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

7. Biological assets (continued)

(b) Measurement of fair values

The Company's standing timber of \$57.4 million is measured at fair value less costs to sell. Fair value is determined using a discounted cash flow valuation technique, which considers the present value of the net cash flows expected to be generated over the next 25 years by the individual private timberlands using a harvest optimization approach, and discounted using a risk-adjusted discount rate.

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, 2019 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

The Company's syndicated 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 certain financial benchmarks.

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, 2019, \$112.8 million was outstanding under the Company's Credit Facility. The interest rate for the Credit Facility was 4.95% at September 30, 2019 (December 31, 2018: 4.65%). The Company was in compliance with its financial covenants as at September 30, 2019.

	September 30, 2019	December 31, 2018
Long-term debt	\$ 112.8	\$ 7.0
Less transaction costs	(0.8)	(1.0)
	<u>\$ 112.0</u>	<u>\$ 6.0</u>
Available	\$ 250.0	\$ 250.0
Drawings	(112.8)	(7.0)
Outstanding letters of credit	(1.0)	(1.0)
Unused portion of Credit Facility	<u>\$ 136.2</u>	<u>\$ 242.0</u>

Western Forest Products Inc.

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9. Income taxes

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Income (loss) before income taxes	\$ (25.7)	\$ 20.8	\$ (24.2)	\$ 88.3
Income tax recovery (expense) at statutory rate of 27% (2018 - 27%)	6.9	(5.6)	6.5	(23.8)
Permanent differences	0.1	(0.1)	0.2	(0.6)
	\$ 7.0	\$ (5.7)	\$ 6.7	\$ (24.4)

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,	
	2019	2018	2019	2018
Current income tax (expense) recovery	\$ 9.6	\$ (6.2)	\$ 9.6	\$ (14.3)
Deferred income tax (expense) recovery	(2.6)	0.5	(2.9)	(10.1)
	\$ 7.0	\$ (5.7)	\$ 6.7	\$ (24.4)

In addition to the amounts recorded to net income, a deferred tax expense of \$0.1 million and a deferred tax recovery of \$0.3 million were recorded in other comprehensive income for the three and nine months ended September 30, 2019, respectively (2018: deferred tax expense of \$0.5 million and \$0.3 million, respectively) in relation to current period actuarial gains (losses) on 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,	
	2019	2018	2019	2018
Reforestation obligation, beginning of period	\$ 25.4	\$ 24.7	\$ 25.7	\$ 25.3
Reforestation provision charged	0.4	1.8	4.9	5.9
Reforestation expenditures	(2.7)	(2.1)	(7.6)	(7.0)
Unwind of discount	0.1	-	0.2	0.2
Reforestation obligation, end of period	23.1	24.4	23.1	24.4
Less current portion	8.8	9.9	8.8	9.9
	\$ 14.3	\$ 14.5	\$ 14.3	\$ 14.5

The reforestation expenditures are expected to occur over the next one to ten years and have been discounted at risk-free rates of 1.36% to 1.72%. The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at September 30, 2019 is \$23.8 million (December 31, 2018: \$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.

11. Other liabilities

	September 30, 2019	December 31, 2018
Employee future benefits obligation ^(Note 14)	\$ 17.7	\$ 19.0
Environmental accruals	1.6	1.5
Performance share unit plan liabilities, non-current ^{(Note 12(d))}	0.8	1.8
Other	1.2	1.5
	\$ 21.3	\$ 23.8

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12. Share capital

(a) Issued and outstanding share capital

	Number of Common Shares	Amount
Balance at December 31, 2018	383,740,519	\$ 491.1
Exercise of stock options	330,000	0.1
Repurchase of shares	(8,873,353)	(11.3)
Balance at September 30, 2019	375,197,166	\$ 479.9

(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 2019, the Company granted 2,487,950 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 \$1.94 per share, risk free interest rate of 1.88%, a volatility rate of 31.86%, and an expected life of seven years. At September 30, 2019, 13,377,189 options (December 31, 2018: 11,965,357) were outstanding under the Company's Option Plan, with a weighted average exercise price of \$1.80 per share.

	Nine months ended September 30, 2019		Nine months ended September 30, 2018	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Outstanding, beginning of period	11,965,357	\$ 1.73	11,718,483	\$ 1.56
Granted	2,487,950	\$ 1.94	1,235,788	\$ 2.74
Exercised	(600,000)	\$ 0.22	(660,000)	\$ 0.59
Forfeited	(476,118)	\$ 2.33	-	-
Outstanding, end of period	13,377,189	\$ 1.80	12,294,271	\$ 1.73

During the three months ended September 30, 2019, there were no options exercised, and during the nine months ended September 30, 2019, 330,000 options were exercised for the issuance of Common Shares, and 270,000 options were exercised on a cashless basis.

During the three and nine months ended September 30, 2019, the Company recorded a compensation expense for these stock options of \$0.2 million and \$0.4 million, respectively (2018: compensation expense of \$0.2 million and \$0.6 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. 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.

Western Forest Products Inc.

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12. Share capital (continued)

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

	Nine months ended September 30, 2019		Nine months ended September 30, 2018	
	Number of DSU	Weighted average unit value	Number of DSU	Weighted average unit value
Outstanding, beginning of period	1,468,754	\$ 1.32	1,282,219	\$ 1.18
Granted	221,279	\$ 1.54	130,534	\$ 2.50
Redeemed	(29,183)	\$ 2.10	-	\$ -
Outstanding, end of period	1,660,850	\$ 1.34	1,412,753	\$ 1.30

During the three and nine months ended September 30, 2019, the Company recorded a compensation recovery for these DSUs of \$0.6 million and \$1.0 million, respectively (2018: compensation recovery of \$0.7 million and \$0.4 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 at the effective date of grant. 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,	
	2019	2018	2019	2018
Outstanding, beginning of period	1,899,697	1,678,522	1,715,332	1,582,285
Granted	36,213	16,850	797,708	542,089
Redeemed	-	-	(577,130)	(429,002)
Outstanding, end of period	1,935,910	1,695,372	1,935,910	1,695,372

During the three and nine months ended September 30, 2019, the Company recorded a compensation recovery for these PSUs of \$0.6 million and \$0.7 million, respectively (2018: compensation recovery of \$0.5 million and expense of \$1.2 million, respectively), with corresponding adjustments to accounts payable and accrued liabilities and other liabilities.

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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. 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.

The Company had met all fibre commitments as at December 31, 2018 and, based on chip and pulp log volumes supplied year-to-date and the exercise of force majeure provisions in connection with strike action by the United Steelworkers Local 1-1937, the Company anticipates satisfying annual fibre commitments for the year ending December 31, 2019.

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 interim 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, 2019, the Company had \$87.2 million of cash on deposit with the US Department of Treasury in respect of these softwood lumber duties (December 31, 2018: \$64.2 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 ("GAAR"). In May 2019, we received further correspondence from the CRA indicating the completion of their extensive audit. The CRA concluded that the matter would not be referred to their GAAR Committee and no further action was warranted, which is consistent with the Company's position that the CRA's earlier position was without merit.

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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, 2019	September 30, 2018
Present value of obligations	\$ 132.4	\$ 127.4
Fair value of plan assets	(114.7)	(109.3)
Liability recognized in the statement of financial position ^(Note 11)	<u>\$ 17.7</u>	<u>\$ 18.1</u>

The change in the liability recognized in the statement of financial position at September 30, 2019 was due primarily to net actuarial losses, resulting from a decrease in the discount rate used to value the defined benefit obligations, partially offset by gains on plan assets and contributions made in the period. The discount rate used as at September 30, 2019 was 2.80% per annum (December 31, 2018: 3.60% per annum).

The Company expects to make funding contributions to its defined benefit plans of \$2.6 million during 2019.

15. Financial instruments – fair values

The Company classifies its financial assets in the following categories: amortized cost, fair value through other comprehensive income ("FVOCI") – debt investment; FVOCI – equity investment; or fair value through profit and loss ("FVTPL"). The Company's non-derivative financial liabilities are measured at amortized cost using the effective interest method.

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value 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. There has been no movement between fair value levels since December 31, 2018. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices that are observable for the assets or liability, either directly or indirectly;
- Level 3: inputs for the asset or liability that are not based on observable market data.

	September 30, 2019			December 31, 2018		
	Mandatory at at FVTPL	Amortized Cost	Total	Mandatory at FVTPL	Amortized Cost	Total
Financial assets						
Market-based investments	\$ 4.9	\$ -	\$ 4.9	\$ 4.9	\$ -	\$ 4.9
Cash and cash equivalents	-	5.1	5.1	-	8.4	8.4
Trade and other receivables	-	31.4	31.4	-	91.3	91.3
Total financial assets	<u>\$ 4.9</u>	<u>\$ 36.5</u>	<u>\$ 41.4</u>	<u>\$ 4.9</u>	<u>\$ 99.7</u>	<u>\$ 104.6</u>
Financial liabilities						
Foreign currency forward contracts	\$ -	\$ -	\$ -	\$ 2.2	\$ -	\$ 2.2
Accounts payable and accrued liabilities	-	43.6	43.6	-	119.2	119.2
Lease liabilities ^(Note 3)	-	22.6	22.6	-	-	-
Long term debt ^(Note 8)	-	112.8	112.8	-	7.0	7.0
Total financial liabilities	<u>\$ -</u>	<u>\$ 179.0</u>	<u>\$ 179.0</u>	<u>\$ 2.2</u>	<u>\$ 126.2</u>	<u>\$ 128.4</u>

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15. Financial instruments – fair values (continued)

As at September 30, 2019, the Company had outstanding obligations to sell an aggregate Japanese Yen (“JPY”) 0.9 million at an average rate of JPY 81.49 per Canadian Dollar (“CAD”) with maturities through October 9, 2019, and an aggregate US Dollar (“USD”) \$10.0 million at an average rate of CAD\$1.33 per USD with maturities through October 29, 2019.

All foreign currency gains or losses related to currency forward contracts to September 30, 2019 have been recognized in revenue for the period and the fair value of these instruments at September 30, 2019 was nominal (December 31, 2018: net liability of \$2.2 million was included in accounts payable and accrued liabilities). A net gain of \$0.5 million was recognized on contracts which were settled in the nine months ended September 30, 2019 (2018: net loss of \$3.2 million), which was included in revenue for the period.

16. 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,	
	2019	2018	2019	2018
Primary geographical markets				
Canada	\$ 45.9	\$ 105.5	\$ 259.6	\$ 342.8
United States	47.4	74.6	186.7	224.2
China	15.4	48.1	125.6	141.8
Japan	25.8	33.5	102.2	115.5
Other	3.7	27.2	39.5	76.6
Europe	3.4	3.6	14.0	11.0
	<u>\$ 141.6</u>	<u>\$ 292.5</u>	<u>\$ 727.6</u>	<u>\$ 911.9</u>
Major Products				
Lumber	\$ 109.7	\$ 238.2	\$ 562.2	\$ 722.0
Logs	27.4	33.6	131.9	123.8
By-products	4.5	20.7	33.5	66.1
	<u>\$ 141.6</u>	<u>\$ 292.5</u>	<u>\$ 727.6</u>	<u>\$ 911.9</u>

Contract balances

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

	September 30, 2019	December 31, 2018
Trade and other receivables	\$ 31.4	\$ 91.3
Contract liabilities	52.9	54.4

The contract liabilities relate to the consideration received from a customer for a long-term fibre supply contract, for which revenue is recognized straight-line over the term of the contract. The contract liabilities decreased \$1.5 million during the period as the amount was recognized as revenue.

17. Non-controlling interest

On March 29, 2019, the Company completed the sale of a 7% ownership interest in its newly formed TFL 44 Limited Partnership (“TFL 44 LP”) to Huumiis Ventures Limited Partnership, a limited partnership beneficially owned by the Huu-ay-aht First Nations. The Company received \$7.3 million in exchange for the 7% ownership interest in TFL 44 LP.

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18. Business combination

On February 1, 2019, the Company completed the acquisition of the assets of Columbia Vista Corporation and certain related entities ("Columbia Vista") located in Vancouver, Washington for consideration of USD\$28.4 million (CAD\$37.7 million). Included in total consideration was USD\$23.8 million (CAD\$31.6 million) for the fair value of property, plant & equipment. The acquisition was accounted for as a business combination, with Western deemed to be the acquirer.

Columbia Vista is a lumber manufacturer that focuses production on Douglas Fir specialty products for the Japan and US markets. This acquisition aligns with the Company's margin-focused business strategy, and the newly combined Company brings together a complementary mix of products, customer relationships, and employees.

The Company incurred total acquisition-related other expenses of \$1.4 million, of which \$0.7 million was recognized in the nine months ended September 30, 2019, and \$0.7 million was recognized in the year-ended December 31, 2018. Since the acquisition date, Columbia Vista has contributed revenue of \$51.8 million and net income of \$3.4 million during the nine months ended September 30, 2019.

The following table presents the preliminary purchase price allocation to the identifiable assets and liabilities based on their estimated fair values on the acquisition date.

Consideration allocated to:

Land	\$	10.6
Buildings		5.3
Equipment		15.7
Inventory		6.6
Prepaid expenses & other		3.5
Right of use assets		0.8
Lease liabilities		(0.8)
Accounts payable		(4.0)
Total consideration	\$	<u>37.7</u>

The fair value of property, plant & equipment was determined considering asset replacement value, net realizable value of the assets acquired and other factors.

The estimated fair values of the assets acquired and liabilities assumed above are based on preliminary information available at the date of preparation of these unaudited consolidated interim financial statements. The Company believes that the preliminary information available provides a reasonable basis for estimating the fair values of the assets acquired and liabilities assumed on the acquisition date. Should the Company obtain new information about facts and circumstances that existed at the acquisition date that would have a material effect on the measurement of the amounts recognized as of the acquisition, the Company will retrospectively adjust the provisional amounts recognized above. The measurement period ends as soon as the Company receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable and cannot exceed one year from the acquisition date.



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DEFINING A HIGHER STANDARD™

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