



Western Forest Products Inc.  
DEFINING A HIGHER STANDARD™

**Western Forest Products Inc.**  
2019 Annual Report

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# Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") reports and comments on the financial condition and results of operations of Western Forest Products Inc. (the "Company", "Western", "us", "we", or "our"), on a consolidated basis, for the three months and year ended December 31, 2019, to help securityholders and other readers understand our company and the key factors underlying our financial results. This discussion and analysis should be read in conjunction with our audited annual consolidated financial statements and the notes thereto for the years ended December 31, 2019 and 2018, which can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

The Company has prepared the consolidated financial statements for the years ended December 31, 2019 and 2018 in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board. Amounts discussed herein are based on our audited annual consolidated financial statements and are presented in millions of Canadian dollars, unless otherwise noted. Certain prior period comparative figures have been reclassified to conform to the current period's presentation. The Company has adopted IFRS 16, *Leases*, with a date of initial application of January 1, 2019, using a modified retrospective approach. Under the modified retrospective approach, the cumulative effect of initial application has been recognized in retained earnings at January 1, 2019, and comparative information has not been restated and continues to be reported under International Accounting Standards ("IAS") 17, *Leases*.

Reference is made in this MD&A to adjusted EBITDA<sup>1</sup>. Adjusted EBITDA is defined as operating income prior to operating restructuring items and other income (expense), plus amortization of property, plant, and equipment and intangible assets, impairment adjustments, and changes in fair value of biological assets. Adjusted EBITDA margin is adjusted EBITDA as a proportion of revenue. Western uses adjusted EBITDA and adjusted EBITDA margin as benchmark measurements of our own operating results and as benchmarks relative to our competitors. We consider adjusted EBITDA to be a meaningful supplement to operating income as a performance measure primarily because amortization expense, impairment adjustments and changes in the fair value of biological assets are non-cash costs, and vary widely from company to company in a manner that we consider largely independent of the underlying cost efficiency of their operating facilities. Further, the inclusion of operating restructuring items which are unpredictable in nature and timing may make comparisons of our operating results between periods more difficult. We also believe adjusted EBITDA and adjusted EBITDA margin are commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

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

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

This MD&A contains statements that may constitute forward-looking statements under the applicable securities laws. Readers are cautioned against placing undue reliance on forward-looking statements. All statements herein, other than statements of historical fact, may be forward-looking statements and can be identified by the use of words such as "will", "estimate", "project", "expect", "anticipate", "plan", "intend", "believe", "seek", "should", "may", "likely", "pursue" and similar references to future periods. Forward-looking statements in this MD&A include, but are not limited to, statements relating to our current intent, belief or expectations with respect to: market and general economic conditions, the United Steelworkers Local 1-1937 labour dispute and the impact of the dispute, the regulatory framework, future costs, available harvest levels, capital allocation including issuance of dividends, and our future operating performance, objectives, capital expenditures and strategies. Although such statements reflect management's current reasonable beliefs, expectations and assumptions as to, amongst other things, the future supply and demand of forest products, global and regional economic activity and the consistency of the regulatory framework within which the Company currently operates, there can be no assurance that forward-looking statements are accurate, and actual results and performance may materially vary. Many factors could cause our actual results or performance to be materially different including: general economic conditions, international demand for the Company's products, the Company's ability to export its products, competition and selling prices, international trade disputes, changes in foreign currency exchange rates, labour disputes and disruptions, natural disasters, relations with First Nations groups, First Nation's claims and settlements, changes in laws, the availability of allowable annual cut and fibre, changes in regulations or public policy affecting the forest industry, changes in opportunities, and other factors referenced under the "Risks and Uncertainties" section herein. The foregoing list is not exhaustive, as other factors could adversely affect our actual results and performance. Forward-looking statements are based only on information currently available to us and refer only as of the date hereof. Except as required by law, we undertake no obligation to update forward-looking statements.

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<sup>1</sup> Earnings Before Interest, Tax, Depreciation and Amortization

Unless otherwise noted, the information in this discussion and analysis is updated to February 11, 2020.

## Summary of Selected Annual Information <sup>(1)</sup>

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

	As at and for the years ended December 31,		
	2019	2018	2017
Revenue			
Lumber	\$ 628.3	\$ 952.9	\$ 858.2
Logs	144.0	160.0	214.8
By-products	35.4	83.8	70.4
Total revenue	\$ 807.7	\$ 1,196.7	\$ 1,143.4
Operating income (loss) prior to restructuring and other items	(46.7)	103.4	117.0
Net income (loss)	(46.7)	69.2	74.4
Adjusted EBITDA	\$ (1.5)	\$ 143.5	\$ 152.6
Adjusted EBITDA margin	-0.2%	12.0%	13.3%
Basic and diluted earnings (loss) per share (in dollars)	\$ (0.12)	\$ 0.18	\$ 0.19
Cash dividends declared per share (in dollars)	0.0875	0.0800	0.0800
Total Assets	\$ 782.5	\$ 855.8	\$ 799.6
Net Debt (Cash) <sup>(2)</sup>	111.3	(2.4)	(35.3)

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

(2) Net debt is defined as the sum of long-term debt, revolving credit facility, less cash and cash equivalents.

## Overview

Financial results in 2019 were significantly impacted by the strike action (the “Strike”) by the United Steelworkers Local 1-1937 (“USW”), which commenced July 1, 2019. The Strike followed a period of weak markets for forest products and a more challenging operating environment in British Columbia (“BC”).

Revenue for 2019 was \$807.7 million, as compared to revenue of \$1,196.7 million in the prior year. Adjusted EBITDA for 2019 was negative \$1.5 million, as compared to adjusted EBITDA of \$143.5 million in 2018, while the net loss for 2019 was \$46.7 million, as compared to net income of \$69.2 million in 2018.

We took steps to mitigate the Strike’s impact on our customers by selling unencumbered inventories, processing certain unencumbered logs at custom cut facilities and growing our wholesale lumber program. In addition, we took steps to protect the balance sheet by deferring certain capital expenditures, managing expenses and drawing down working capital.

Despite the impact of the Strike and a more challenging operating environment, we continued to make significant progress implementing our strategic initiatives in 2019, including:

- Growing our specialty products business with the asset acquisition of Vancouver, Washington based Columbia Vista Corporation and related entities on February 1, 2019. See “*Summary of 2019 Annual Results – Columbia Vista Acquisition*” for further information.
- Advancing our strategic partnerships with First Nations and continuing to reposition our coastal tenure assets. On March 29, 2019, we completed the sale of a 7% interest in our newly formed TFL 44 Limited Partnership (“TFL 44 LP”) to the Huumiis Ventures Limited Partnership (a limited partnership beneficially owned by the Huu-ay-aht First Nations) (“HVLP”) for gross proceeds of \$7.3 million. See “*Summary of 2019 Annual Results – Sale of Ownership Interest in Port Alberni Forest Operations*” for further information.
- Substantially completing equipment and building upgrades at our Arlington facility and commencing with commissioning and the ramp up of lumber remanufacturing operations. Our Arlington facility will assist us in re-positioning and growing our product lines, streamlining our logistics and distribution platform moving us closer to the final customer.
- More than doubling our wholesale lumber business shipments to 34 million board feet in 2019, as compared to 16 million board feet in 2018. Our wholesale lumber business will allow us to offer an expanded product line, making us more meaningful to our selected customers and further enhancing the viability and success of our coastal sawmills. Our wholesale lumber business has also helped play an important role in supporting our customers during the Strike.

- Executing our sales and marketing strategy, which focuses on the production and sale of targeted, high-margin products of scale to selected customers.
- Further demonstrating our commitment to top tier governance practices. In 2019, we appointed Michael Waites as independent Chair of the Board, added independent directors Laura Cillis and Cheri Phyfer to the Board as Directors, and reconstituted the membership of the Board sub-committees.
- Publishing our inaugural sustainability report to provide expanded environmental, social and governance disclosure of our progress in, and commitment to, defining a higher standard in sustainable management and environmental stewardship.
- Implementing important foundational systems and adjusting our organizational structure and staffing, in support of our growth strategy.
- Continuing with our balanced approach to capital allocation by returning \$34.0 million to shareholders through regular, quarterly dividends and repurchasing \$15.9 million of our outstanding common shares for cancellation under our normal course issuer bid in 2019.

On February 10, 2020, the Company announced that it had reached a tentative collective agreement with the USW. The tentative agreement is subject to a ratification vote by USW membership. The USW bargaining committee has advised that they will be recommending its members accept the agreement.

As we look forward to 2020, we are excited to have our employees and contractors return to work. Moving forward, we will continue to align our production volumes to match market demand and will look to strengthen our customer relationships. Our long-term focus remains the same; implementing our strategic initiatives to strengthen our foundation; grow our base; and grow our business. We remain committed to a balanced approach to capital allocation, while also considering internal and external growth opportunities to grow long-term shareholder value.

## Summary of Selected Quarterly and Annual Results <sup>(1)</sup>

	Q4 2019	Q4 2018	Q3 2019	Annual 2019	Annual 2018	
<i>(millions of Canadian dollars except per share amounts and where otherwise noted)</i>						
<b>Summary Information</b>						
Revenue						
Lumber	\$ 66.1	\$ 230.9	\$ 109.7	\$ 628.3	\$ 952.9	
Logs	12.1	36.2	27.4	144.0	160.0	
By-products	1.9	17.7	4.5	35.4	83.8	
Total revenue	\$ 80.1	\$ 284.8	\$ 141.6	\$ 807.7	\$ 1,196.7	
Freight	\$ 5.1	\$ 24.4	9.5	\$ 64.1	\$ 90.6	
Export tax	3.4	10.1	5.5	27.8	43.0	
Stumpage	-	13.8	-	26.0	52.7	
Adjusted EBITDA	\$ (18.1)	\$ 18.0	\$ (16.6)	\$ (1.5)	\$ 143.5	
Adjusted EBITDA margin	-22.6%	6.3%	-11.7%	-0.2%	12.0%	
Operating income (loss) prior to restructuring and other items	\$ (29.6)	\$ 7.7	\$ (24.2)	\$ (46.7)	\$ 103.4	
Net income (loss)	(29.2)	5.3	(18.7)	(46.7)	69.2	
Basic and diluted earnings (loss) per share (in dollars)	(0.09)	0.02	(0.05)	(0.12)	0.18	
<b>Operating Information</b>						
<b>Lumber<sup>(2)</sup></b>						
Lumber Shipments – millions of board feet						
Western Red Cedar	18	47	26	139	205	
Japan Specialty	13	37	19	102	138	
Niche	4	24	13	79	96	
Commodity	9	110	32	228	441	
Total	44	218	90	548	880	
Lumber Production – millions of board feet	34	200	48	491	864	
Lumber Price – per thousand board feet	\$ 1,502	\$ 1,059	\$ 1,219	\$ 1,147	\$ 1,083	
Wholesale Lumber Shipments - millions of board feet	10	3	11	34	16	
<b>Logs<sup>(3)</sup></b>						
Log Shipments – thousands of cubic metres						
Export	22	1	2	129	65	
Domestic	70	222	193	842	1,037	
Pulp	43	146	51	315	407	
Total	135	369	246	1,286	1,509	
Net production – thousands of cubic metres <sup>(4)</sup>	21	1,135	21	2,214	4,328	
Saw log purchases – thousands of cubic metres	34	212	84	564	979	
Log Price – per cubic metre <sup>(5)</sup>	\$ 87	\$ 98	\$ 110	\$ 105	\$ 106	
<b>Illustrative Lumber Average Price Data<sup>(6)</sup></b>						
	<b>Price Basis</b>					
Grn WRC #2 Clear & Btr 4x6W RL (\$C)	c.i.f. dest. N Euro	\$ 4,478	\$ 5,133	\$ 4,400	\$ 4,492	\$ 5,100
Grn WRC Deck Knotty 2x6 RL S4S	Net f.o.b. Mill	\$ 1,340	\$ 1,418	\$ 1,340	\$ 1,346	\$ 1,493
Grn WRC #2 & Btr AG 6x6 RL	Net f.o.b. Mill	\$ 2,291	\$ 2,245	\$ 2,246	\$ 2,257	\$ 2,134
Coast Grn WRC Std&Btr NH 3/4x4 RL S1S2E	Net f.o.b. Mill	\$ 1,095	\$ 1,146	\$ 1,095	\$ 1,096	\$ 1,171
Grn Hem Baby Squares Merch 4-1/8x4-1/8 13' S4S	c.&f. dest. Japan	\$ 827	\$ 1,000	\$ 855	\$ 879	\$ 949
Grn Dfir Baby Squares Merch 4-1/8x4-1/8 RL S4S	c.&f. dest. Japan	\$ 1,035	\$ 1,200	\$ 1,072	\$ 1,096	\$ 1,189
KD White Fir Shop Moulding&Btr C&Btr 5/4 S2S	Net f.o.b. Mill	\$ 1,085	\$ 1,080	\$ 1,080	\$ 1,081	\$ 1,075
Grn Dfir (Portland) #1&Btr 100% FOHC 6x6 Rough	Net f.o.b. Mill	\$ 1,234	\$ 1,358	\$ 1,206	\$ 1,256	\$ 1,369
Hemlock Lumber 2x4 (40x90) Metric RG Utility	c.i.f. dest. Shanghai	\$ 397	\$ 440	\$ 401	\$ 409	\$ 486
Average Exchange Rate – CAD to USD		0.758	0.756	0.757	0.754	0.771
Average Exchange Rate – CAD to JPY		82.37	85.32	81.27	82.18	85.19

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

(2) Includes Columbia Vista operations, acquired February 1, 2019, and wholesale lumber shipments.

(3) BC business only.

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

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

(6) Sourced from Random Lengths in USD/Mfbm, except Hemlock Lumber Metric RG Utility that is sourced from China Bulletin.

## Summary of Fourth Quarter 2019 Results

Fourth quarter results were significantly impacted by the Strike, as all of our timberlands and most of our BC based manufacturing operations were curtailed. We took steps to mitigate the Strike's impact on our customers, business and cash flows by selling the majority of our remaining unencumbered lumber inventory, processing certain unencumbered logs at custom cut facilities, drawing down working capital, and deferring certain expenditures.

Adjusted EBITDA for the fourth quarter of 2019 was negative \$18.1 million, as compared to positive adjusted EBITDA of \$18.0 million from the same period last year. Operating loss prior to restructuring and other items was \$29.6 million, as compared to operating income of \$7.7 million in the same period last year.

### *Sales*

Lumber and log sales volume and revenue were impacted by the Strike. Lumber revenue in the fourth quarter was \$66.1 million, a decrease of 71.4% from the same period last year. Lumber shipment volumes were 79.8% lower than the same period last year due to the Strike, as most of our manufacturing operations were shutdown in the fourth quarter of 2019. We sold the majority of our remaining unencumbered lumber inventory, processed certain unencumbered logs at custom cut facilities, and continued to execute on our wholesale lumber program to service our customers and help mitigate the impact of the Strike. Our United States ("US") based Columbia Vista division continued to perform in line with our expectations and has been a positive addition to our business and product mix.

Our average realized lumber pricing increased 41.8% as the result of an improved specialty product mix, which was partially offset by a stronger Canadian dollar ("CAD") to United States dollar ("USD"). Specialty lumber represented 79.1% of fourth quarter shipments compared to 49.5% in the same period last year, as we leveraged our wholesale lumber business and custom cut production to supply our customers.

Log revenue was \$12.1 million in the fourth quarter of 2019, a decrease of 66.6% from the same period last year. To mitigate the impact of the Strike on our business, we sold certain unencumbered log inventory to help manage cash flow and reduce working capital levels.

By-product revenue was \$1.9 million, a decrease of 89.3% as compared to the same period last year as most of our BC coastal operations were shut down due to the Strike.

### *Operations*

To support our selected customers during the Strike, we continued to redirect available inventory to active divisions. We operated on a sub-optimal basis resulting in higher transportation and operating costs. Operating expenses included \$16.7 million arising from curtailed operations and related operating inefficiencies as a result of the Strike.

Leading up to the Strike, we drew down inventory at USW-certified operations to supply our remanufacturing and custom cut operations. However, as certain inventory was encumbered by the Strike and degraded over the fourth quarter of 2019, we expensed an additional \$2.4 million provision against this restricted inventory.

Lumber production of 34 million board feet was 83.0% lower than the same period last year. Incremental production from our US-based Columbia Vista division, acquired in 2019, and volumes from our custom cut program was more than offset by the curtailment of our BC operations due to the Strike.

We produced 21,000 cubic meters of logs from our BC coastal operations in the fourth quarter of 2019 compared to production of 1,135,000 cubic metres in the same quarter of last year. Fourth quarter log production in 2019 was sourced from joint ventures and limited partnerships, as all our USW-certified timberlands operations were curtailed due to the Strike.

BC coastal saw log purchases were 34,000 cubic metres, an 84.0% decrease from the same period last year. Weaker markets and government policy decisions led to a significant decline in coastal log harvest that reduced market log availability. We sourced our saw log purchases from pre-existing purchase commitments and our joint venture arrangements.

Freight expense decreased by \$19.3 million from the same period last year due to lower shipment volumes.

Fourth quarter adjusted EBITDA and operating income included \$3.4 million of countervailing duty (“CVD”) and anti-dumping duty (“AD”), as compared to \$10.1 million in the same period last year. Duty expense declined as a result of reduced US-destined lumber shipment volumes. For further information on CVD and AD see “*Softwood Lumber Dispute and US Market Update*”.

### *Selling and Administration Expense*

Fourth quarter selling and administration expense was \$8.0 million in 2019 as compared to \$7.6 million in the same period last year. Incremental legal expenses relating to the Strike more than offset cost mitigation savings.

### *Finance Costs*

Finance costs were \$2.2 million, compared to \$0.7 million in the same period last year. This was primarily due to a higher average outstanding debt balance and higher average interest rates in 2019. As at December 31, 2019, the Company had drawn \$114.1 million on its credit facility. See “*Financial Position and Liquidity*” for further information.

### *Net Income (Loss)*

Net loss for the fourth quarter of 2019 was \$29.2 million, as compared to net income of \$5.3 million for the same period of 2018. Results were significantly impacted by the Strike.

## **Summary of 2019 Annual Results**

Adjusted EBITDA for the year was negative \$1.5 million, as compared to positive \$143.5 million from the same period last year. Operating loss prior to restructuring and other items was \$46.7 million, compared to operating income of \$103.4 million during the same period last year.

### *Sales*

Lumber revenue was \$628.3 million, a decrease of 34.1% from the same period last year, primarily due to the Strike and more challenging market conditions. Despite the decline in market pricing, our average lumber price realizations increased, benefitting from a higher specialty product mix and a weaker CAD to USD. Specialty lumber represented 58.3% of 2019 annual shipments, compared to 49.9% last year. Despite a more challenging year, we were successful in more than doubling our wholesale lumber volume to service our customers and help mitigate the impact of the Strike.

Log revenue was \$144.0 million, a decrease of 10.0% compared to the same period last year. Log revenue benefited from the resumption of our export log sales program in the second quarter of 2019 but was offset by the impact of the Strike in the third and fourth quarters of 2019.

By-products revenue decreased to \$35.4 million, from \$83.8 million last year, primarily due to lower production and shipments as a result of the Strike. Other factors included declining BC coastal chip prices and lower chip purchase-and-resale volume.

### *Operations*

Lumber production of 491 million board feet was 43.2% lower than the same period last year. Market-related sawmill curtailments and the Strike led to lower production, which more than offset the inclusion of results from our US-based Columbia Vista division.

Log production was 2,214,000 cubic metres, 48.8% lower than the same period last year, primarily due to the Strike in the second half of 2019.

BC coastal saw log purchases were 564,000 cubic metres, a 42.4% decrease from the same period last year, as we managed log purchases to available capacity to support customer needs.

Freight expense decreased by \$26.5 million as compared to last year, primarily due to lower shipment volumes as a result of the Strike.

Adjusted EBITDA and operating income included \$27.8 million of CVD and AD expense, as compared to \$43.0 million in 2018. Duty expense declined as a result of reduced US-destined lumber shipment volumes due to the Strike.

### *Selling and Administration Expense*

Selling and administration expense was \$31.1 million, as compared to \$32.0 million during the same period last year. We took steps to reduce and manage expenses in order to mitigate increased legal expense and operating losses resulting from the Strike.

### *Finance Costs*

Finance costs were \$7.8 million, compared to \$2.7 million in 2018, primarily due to comparatively higher average outstanding debt and higher average interest rate in 2019.

As a result of adopting IFRS 16, *Leases* on January 1, 2019, we recognized \$0.8 million of finance costs on lease payments in 2019. In comparative periods, leasing finance costs were recognized in operating income.

### *Net Income (Loss)*

Net loss for 2019 was \$46.7 million, as compared to net income of \$69.2 million last year. Net income for the year was lower due to the Strike, which largely curtailed operations in the second half of 2019.

### *Columbia Vista Asset Acquisition*

On February 1, 2019, we completed the asset acquisition of Vancouver, Washington based Columbia Vista Corporation and related entities. This acquisition is consistent with our strategy of pursuing margin-focused business opportunities that complement our position in selected markets. Bringing Western and Columbia Vista together provides us the opportunity to expand our Douglas fir specialty product offerings, particularly in Japan, which will support our BC-based Hemlock programs. The combination of Columbia Vista and Western makes us more meaningful to our selected customers and creates a stronger company for all our employees.

### *Sale of Ownership Interest in Port Alberni Forest Operations*

On March 29, 2019, we completed the sale of a 7% interest in our newly formed TFL 44 LP to HVLP for gross proceeds of \$7.3 million. As part of the agreement, HVLP may acquire an additional interest in the TFL 44 LP, which may include a majority interest, subject to further negotiations. TFL 44 LP's assets consist of TFL 44 and certain other associated assets and liabilities of our Port Alberni Forest Operation. We will continue to source fibre from TFL 44 LP to support our BC manufacturing facilities.

### *Arlington Operation*

During 2019, we completed infrastructure and equipment upgrades and commenced secondary processing. However, the expected ramp up of production at the facility has been partially impacted by the Strike and a lack of wholesale lumber supply due to market conditions. Our Arlington facility is currently operating on a reduced basis due to a lack of lumber supply resulting from the Strike.

## **Operating Restructuring Items**

We incurred \$3.5 million of operating restructuring costs in 2019, including \$1.4 million of non-operating costs incurred due to the indefinite curtailment of the Company's Somass sawmill in 2017. During the fourth quarter of 2019, we incurred \$2.1 million in severance and related expenses due to a reduction of approximately 10% in salaried employees as a cost mitigation initiative to limit losses arising from the Strike.

Operating restructuring costs were \$4.8 million in 2018, due primarily to the indefinite curtailment of our Somass sawmill, business optimization initiatives and closure of the Englewood train.

## **Income Taxes**

Lower operating earnings led to an income tax recovery of \$16.7 million being recognized in 2019, as compared to income tax expense of \$25.6 million in 2018.

At December 31, 2019, the Company and its subsidiaries had unused non-capital loss carry forwards totalling approximately \$24.1 million in Canada, and \$5.2 million in the US, which can be used to reduce taxable income. In addition, the Company has unused capital losses carried forward of approximately \$87.9 million in Canada, which are available indefinitely.

## **Labour Relations Update**

Western began negotiations with the USW, the union representing approximately 1,500 of our hourly employees and 1,500 employees working for our timberland contractors in BC, in April 2019 for a new collective agreement to replace our prior agreement, which expired mid-June 2019.

The USW served seventy-two hours' notice of strike action on the Company and some of its contractors on June 28, 2019. On July 1, 2019, the USW commenced a strike. The Strike is ongoing for all of our USW certified manufacturing and timberlands operations. The Strike is also indirectly impacting certain non-USW certified manufacturing operations, including our Ladysmith sawmill (due to insufficient log supply) and our Value-Added remanufacturing facility (due to a lack of lumber supply). Our US based Arlington and Columbia Vista divisions continue to operate, although our Arlington facility is operating on a reduced basis due to a lack of lumber supply caused by the Strike.

Upon receiving strike notice from the USW, we commenced our work stoppage contingency plan with a goal to protect our balance sheet while mitigating the impact of the Strike on our Company, customers and business partners.

On September 13, 2019, the Company and the USW commenced mediation with independent mediators; however, the USW withdrew from mediation with the Company and independent mediators after several hours of talks. The Company and USW subsequently met with the independent mediators on several occasions to resume talks, but on December 17, 2019, negotiations reached an impasse.

On February 6, 2020, the BC Minister of Labour appointed Special Mediators to work with the Company and USW for a period of 10 days to determine if a negotiated settlement could be reached. On February 10, 2020, the Company announced that terms of a tentative collective agreement had been reached. The tentative agreement is subject to a ratification vote by USW membership. The USW bargaining committee has advised that they will be recommending its members accept the agreement. The USW has advised its members that the ratification voting will occur shortly. For a comprehensive history of the Strike please see "*Risks and Uncertainties – Employees and Labour Relations*".

Despite terms of a tentative collective agreement being reached, the Strike is expected to have a negative impact on our first quarter results in 2020 compared to the same period last year, but we are unable to determine the magnitude of that impact at this time.

## **BC Government Forest Policies**

In 2018, the BC Provincial Government (the "Province") introduced a Coastal Revitalization Initiative and further policy initiatives that will affect the BC forest sector regulatory framework. On January 17, 2019, the Premier announced the Province's commitment to make changes to BC's log export policies or rules, Bill 13 and waste policies with the intent to increase domestic and value-added manufacturing in BC.

On April 1, 2019, the Province announced the creation of fibre recovery zones, which are intended to increase the supply of residual fibre from primary harvesting for secondary users. Western estimates that approximately 70% of our timberland operations will be impacted with the creation of fibre recovery zones. The impacts to our business include the potential for higher costs and lower log harvest volumes. The Province has been clear that they do not want to see unintended consequences from the policy implementation. We continue to collaboratively engage with the Province and other stakeholders to ensure that the desired outcome of the policy, less fibre waste and more fibre for domestic manufacturing and pulp production, is met without the unintended consequences of higher costs and less harvest volume for timberland operators.

On April 11, 2019, the Province announced Bill 22, *Forest Amendment Act, 2019*, which came into force on May 30, 2019. The amendments to the *Forest Act* will require tenure holders to receive approval from the Minister before disposing or transferring a tenure agreement to a third party. These amendments will enable the Minister to refuse to approve, or place conditions on the approval of, a disposition or transfer if it is deemed not to be in the public interest or detrimental to competition in the buying or selling of timber or residuals.

On May 16, 2019, Bill 21, *Forest and Range Practices Amendment Act, 2019*, designed to increase opportunities for public input, improve information sharing on forest planning, strengthen the Minister's ability to manage forest activity, expand the definition of wildlife to help protect at-risk species and improve and streamline range-use planning was put into force.

On July 10, 2019, the Province announced the application of a targeted fee-in-lieu of manufacturing for exported logs harvested from BC Timber Sales, as a step towards ensuring that more logs are processed in BC.

On July 17, 2019, the Province announced that a two-person panel had been appointed to lead an Old Growth Strategic Review and provide a report to the Minister of Forests, Lands, Natural Resource Operations and Rural Development (the "MFLNRORD"). The panel will report back to government in spring 2020 with recommendations that are expected to inform a new approach to old-growth management for BC.

On November 28, 2019, Bill 41, Declaration on the Rights of Indigenous Peoples Act (the "Act") came into force. The Act is intended to guide the implementation of the principles of the United Nations Declaration on the Rights of Indigenous Peoples ("UNDRIP") and makes BC the first province in Canada to legally implement UNDRIP. The Act requires the Province to align all laws with UNDRIP, to develop an action plan to achieve this, and regularly report to the legislature to monitor progress. The current Federal Government has also pledged to implement UNDRIP and the Calls to Action of the Truth and Reconciliation Commission. Significant expectation has been raised among Aboriginal groups in BC and across the country as to the impact that this Act and the Federal Government's commitments may have on efforts to achieve true reconciliation with Aboriginal groups. At this time, the Company is unable to predict the outcome of the Act and the implementation of these commitments on Western's ongoing operations or on any sale of its non-core assets and private lands.

In December 2019, the MFLNRORD, indicated that there would be a delay in expanding the fee-in-lieu payment for raw log exports to all cutting permits on the BC coast by six months and that the Province would be shrinking the penalties and zones for fibre recovery zones. Specific details of these policies changes have not been disclosed.

On January 21, 2020, the Province announced changes to the Manufactured Forest Products Regulation effective July 1, 2020 to ensure more accessibility to fibre for local manufacturers. The regulation amendments require lumber that is made from Western Red Cedar ("WRC") or cypress (yellow cedar) to be fully manufactured to be eligible for export. Fully manufactured is defined as lumber that will not be kiln-dried, planed or re-sawn at a facility outside of BC.

The impact these policy initiatives may have on our operations cannot be determined at this time.

Separately, on December 20, 2019, the Company was notified by the MFLNRORD that an alternative method of scale would apply for all the Company's timber that was cut prior to July 1, 2019 and had not been scaled. The Company is required to compile and submit a report of all the timber to MFLNRORD, which will result in stumpage expense becoming payable shortly thereafter. The Company has requested clarification from MFLNRORD and cannot determine the financial impact at this time. We have not accrued for any incremental stumpage expense that may become payable under this alternative scaling method as at December 31, 2019.

## **Sawmill and Remanufacturing Curtailments**

Due to market conditions in 2019, our Cowichan Bay sawmill was temporarily curtailed for a two-week period beginning March 25, 2019, and our Alberni Pacific sawmill was temporarily curtailed for a four-week period beginning March 18, 2019. Our Ladysmith sawmill was temporary curtailed for a two-week period beginning May 6, 2019, due to constrained log supply.

On June 6, 2019, we announced temporary production curtailments at three of our sawmills to align production volumes to customer demand. We curtailed our Duke Point sawmill for two weeks and our Saltair sawmill for one week in June. We reduced operating levels at our Chemainus sawmill from 120 hours per week to 80 hours per week.

On July 24, 2019, we announced an additional temporary curtailment at our Ladysmith sawmill due to illegal strike action taken by the USW, which impeded log supply to the mill. Subsequent to this announcement, the Labour Relations Board confirmed their earlier ruling that the USW tactics were illegal and ordered the USW to refrain from impeding log delivery to the mill. The Ladysmith sawmill continued to operate until it was curtailed on August 23, 2019, due to limited log supply.

On September 6, 2019, our BC Value-Added remanufacturing facility was curtailed in response to limited lumber supply as a result of the Strike. The facility restarted during the fourth quarter of 2019, but its operations were limited.

Due to limited lumber volumes from our suppliers our Arlington remanufacturing facility in Washington State operated sporadically in the second half of 2019.

## Financial Position and Liquidity

<i>(millions of Canadian dollars except where otherwise noted)</i>	<b>Q4 2019</b>	<b>Q4 2018</b>	<b>Q3 2019</b>	<b>Annual 2019</b>	<b>Annual 2018</b>
<b>Selected Cash Flow Items</b>					
<b>Operating Activities</b>					
Net income (loss)	\$ (29.2)	\$ 5.3	\$ (18.7)	\$ (46.7)	\$ 69.2
Amortization	12.4	9.9	9.2	45.4	40.2
Income taxes paid	-	-	6.1	(17.0)	0.3
Other	(1.3)	2.9	(12.5)	(11.2)	23.6
Subtotal	(18.1)	18.1	(15.9)	(29.5)	133.3
Change in non-cash working capital	24.9	(12.5)	38.2	40.0	(15.1)
Cash provided by operating activities	\$ 6.8	\$ 5.6	\$ 22.3	\$ 10.5	\$ 118.2
<b>Investing Activities</b>					
Additions to property, plant and equipment	\$ (1.4)	\$ (27.4)	\$ (2.4)	\$ (26.7)	\$ (70.6)
Additions to capital logging roads	(0.2)	\$ (3.6)	(1.3)	(10.5)	(12.9)
Purchase of Arlington facility	-	-	-	-	(11.6)
Purchase of Columbia Vista	-	-	-	(37.7)	-
Proceeds from non-controlling interest	-	-	0.8	7.0	-
Other	2.4	2.0	1.5	4.7	3.1
Cash provided by (used in) investing activities	\$ 0.8	\$ (29.0)	\$ (1.4)	\$ (63.2)	\$ (92.0)
<b>Financing Activities</b>					
Draw on (repayment of) long-term debt	\$ 1.3	\$ -	\$ (7.5)	\$ 107.1	\$ 7.0
Dividends	(8.5)	(8.7)	(8.4)	(34.0)	(34.3)
Share repurchases	-	(9.1)	(1.9)	(15.9)	(25.2)
Other	(3.4)	6.8	(3.3)	(10.8)	(0.6)
Cash provided by (used in) financing activities	\$ (10.6)	\$ (11.0)	\$ (21.1)	\$ 46.4	\$ (53.1)
Decrease in cash	\$ (3.0)	\$ (34.4)	\$ (0.2)	\$ (6.3)	\$ (26.9)
<b>Summary of Financial Position</b>					
Cash and cash equivalents	\$ 2.1	\$ 8.4	\$ 5.1		
Current assets	188.9	297.9	222.4		
Current liabilities	48.6	142.7	57.8		
Total debt, net of deferred financing costs	113.4	6.0	112.0		
Net debt (cash) <sup>(1)</sup>	111.3	(2.4)	106.9		
Equity	481.8	572.9	519.1		
Total liquidity <sup>(2)</sup>	136.9	250.4	141.3		
<b>Financial ratios:</b>					
Current assets to current liabilities	3.89	2.09	3.85		
Net debt to capitalization <sup>(3)</sup>	18.8%	0.0%	17.1%		

(1) Net debt (cash) is defined as the sum of long-term debt, less cash and cash equivalents.

(2) Total liquidity comprises cash and cash equivalents, and available credit under the Company's credit facility.

(3) Capitalization comprises net debt and shareholders' equity.

Cash provided by operating activities in 2019 was \$10.5 million as compared to \$118.2 million in 2018. We successfully reduced our non-cash working capital by \$40.0 million in 2019 to partly offset significantly reduced cash from operations resulting from the Strike.

Cash used in investing activities was \$63.2 million in 2019, which includes the \$37.7 million asset acquisition of Columbia Vista and \$7.3 million to complete infrastructure and equipment upgrades at our Arlington facility. Cash used in investing activities in 2018 was \$92.0 million, including the \$11.6 million purchase of the Arlington facility.

In the second half of 2019, we reduced our capital spending in order to manage cash flow during the Strike, and incurred only safety, environmental and committed capital expenditures. These capital expenditures were partially offset by proceeds from the sale of an ownership interest in TFL 44 LP and the sale of certain non-core land assets. Our strategic capital program is discussed in more detail under “*Strategy and Outlook*”.

Cash provided by financing activities increased to \$46.4 million in 2019, as compared to cash used of \$53.1 million in 2018. In 2019, we returned \$34.0 million to shareholders through quarterly dividends and repurchased our common shares for cancellation under our normal course issuer bid for \$15.9 million.

### *Liquidity and Capital Resources*

On August 8, 2018, we entered into a \$250 million syndicated credit facility. The facility matures on August 1, 2022, and includes an accordion feature to access an additional \$100 million of debt. The credit facility, in addition to cash generated from operations, will be used to support working capital requirements, debt servicing commitments and capital expenditures.

Total liquidity was \$136.9 million at December 31, 2019, compared to \$250.4 million at the end of 2018. Liquidity is comprised of cash and cash equivalents of \$2.1 million and unused availability under the credit facility of \$134.8 million.

At December 31, 2019, the Company had contractual commitments to acquire property, plant and equipment in the amount of \$7.5 million.

Based on our current forecasts, we expect sufficient liquidity will be available to meet these commitments as well as our other obligations in 2020. The Company was in compliance with all its financial covenants as at December 31, 2019.

### *Summary of Contractual Obligations*

The following table summarizes our contractual obligations at December 31, 2019, and our payments due for each of the next five years and thereafter, including estimated interest payments:

<i>(millions of Canadian dollars)</i>	Total	2020	2021	2022	2023	2024	Thereafter
Accounts payable and accrued liabilities	\$ 35.0	\$ 35.0	\$ -	\$ -	\$ -	\$ -	\$ -
Purchase commitments	16.2	16.2	-	-	-	-	-
Long-term debt	130.2	6.0	3.0	121.2	-	-	-
Lease liabilities	20.2	5.6	4.8	3.7	1.7	1.5	2.9
Reforestation obligation	24.3	8.7	4.2	2.6	1.7	1.3	5.8
Defined benefit pension plan funding obligation	19.6	2.6	2.6	2.6	2.5	2.5	6.8
	<u>\$ 245.5</u>	<u>\$ 74.1</u>	<u>\$ 14.6</u>	<u>\$ 130.1</u>	<u>\$ 5.9</u>	<u>\$ 5.3</u>	<u>\$ 15.5</u>

## **Capital Allocation**

### *Normal Course Issuer Bid*

On August 2, 2019, the Company renewed its Normal Course Issuer Bid (“NCIB”) permitting the purchase and cancellation of up to 18,763,888 of the Company’s common shares or approximately 5% of the common shares issued and outstanding as of August 1, 2019. The Company also entered into an automatic share purchase plan with its designated broker to facilitate purchases of its common shares under the NCIB at times when the Company would ordinarily not be permitted to purchase its common shares due to regulatory restrictions or self-imposed blackout periods.

The Company's previous NCIB to purchase for cancellation up to 19,662,439 common shares expired on August 7, 2019. Under the previous NCIB, the Company purchased 18,381,621 common shares for \$35.4 million, at a volume weighted average price of \$1.92 per common share, representing approximately 4.7% of the total shares outstanding at the commencement of our previous NCIB.

During 2019, the Company repurchased 8,873,353 common shares under the NCIB for \$15.9 million at an average price of \$1.79 per common share. As at February 11, 2020, 18,763,888 common shares remain available to be purchased under the current NCIB. The NCIB expires on August 7, 2020.

## **Strategy and Outlook**

Western's long-term business objective is to create superior value for shareholders by building a margin-focused log and lumber business of scale to compete successfully in global softwood markets. We believe this will be achieved by maximizing the sustainable utilization of our forest tenures, operating safe, efficient, low-cost manufacturing facilities and augmenting our sales of targeted high-value specialty products for selected global customers with a lumber wholesale program. We seek to manage our business with a focus on operating cash flow and maximizing value through the production and sales cycle. We routinely evaluate our performance using the measure of Return on Capital Employed.

Continuing to guide our actions are the strategic initiatives presented below, with selected accomplishments:

### ***Strengthen the Foundation***

- Through our focused capital investments, we have positioned Western as the only company on the coast of BC capable of consuming the complete profile of the coastal forest and competitively manufacturing a diverse product mix.
- Our strategic capital investments have allowed us to increase the production of targeted products and supported the optimization of our coastal operations.
- We have invested in our people and systems to create a platform for pursuing margin-focused growth opportunities.
- We continue to pursue long-term relationships with coastal First Nations to create mutually beneficial opportunities. In 2019, we completed the sale of an ownership interest in our Port Alberni Forest Operation to HVLP, aligning our interests and introducing an opportunity to potentially involve other First Nations in a shared vision for forestry.

### ***Grow the Base***

- We optimized our operations and invested in our sawmills and timberlands to improve margins and position ourselves for growth. We continue to look for opportunities to further optimize our operations to enhance profit margins.
- We implemented multiple non-capital margin improvement programs to improve our cost structure and optimize our supply chain.
- The success of our business relationships with First Nations has and continues to drive incremental log volume and enabled Western to grow specialty lumber production in recent years.
- We are executing on our sales and marketing strategy, driving the production and sale of targeted, high-margin products of scale to selected customers that value our product offerings.

### ***Explore Opportunities***

- In 2018, we acquired our Arlington distribution and processing facility. The facility allows the Company to increase the production of targeted, finished products while also providing a centralized warehousing and distribution centre to more effectively service our selected US customers.
- In 2019, we acquired the assets of Columbia Vista in Vancouver, Washington, enabling us to offer a broader array of Douglas fir specialty products to our selected customers in both the US and Japan.
- We launched a new wholesale business which will provide complementary products to our industry leading specialty product offerings and enhance our return on capital employed.
- We continue to evaluate opportunities to grow our business and long-term shareholder value.

### ***Sales & Marketing Strategy Update***

We continue to progress with the execution of our sales and marketing strategy, which focuses on the production and sale of targeted, high-margin products of scale to selected customers. We supplement our key product offerings with purchased lumber to deliver the suite of products our customers require. Our Columbia Vista division continues to perform in line with our expectations and has been a positive addition to our business and product mix. During 2019 we continued to develop and evaluate growth opportunities for our wholesale lumber business, including more than doubling our shipments to 34 million board feet.

### ***Market Outlook***

Our long-term view of market fundamentals remains unchanged. In North America, rising lumber consumption will be driven by increased new home construction, a robust repair and renovation sector and growth of mass timber building technologies. Growing demand and reduced supply due to North American sawmill curtailments is expected to improve market fundamentals and benefit the industry long-term.

Despite positive long-term growth drivers, lumber markets were challenged in 2019 as North American weather events, skilled labour constraints and higher mortgage rates stalled US new home construction and muted growth in repair and renovation spending. In response to weak demand, temporary and permanent production curtailments were announced in the forestry sector. The supply impacts of these announcements are expected to support lumber pricing in 2020.

We are encouraged by the positive market sentiment regarding WRC products heading into the spring building season. Low in-market inventories and recent BC coastal cedar manufacturing closures should benefit WRC product pricing going forward.

In Japan, we expect steady demand for our Douglas fir products, however increased competition from European engineered wood products may pressure pricing. We expect market share erosion and weaker pricing for BC coastal Hemlock lumber in Japan due to the supply shortages as a result of the Strike and increased competition from Japanese Government subsidized domestic species. The Strike has resulted in certain Japanese Hemlock lumber customers switching to competing products. We plan to leverage Columbia Vista's strong and loyal Douglas fir customer base, as well as develop marketing strategies, to help regain our Japanese Hemlock lumber market share.

We anticipate demand for appearance Niche products to improve, resulting in modest price gains. In addition, we expect steady demand in North America for timbers and industrial products due to large scale industrial oil and gas projects currently underway in Canada.

Commodity lumber markets in North America are likely to benefit from previously announced temporary and permanent production curtailments, but we expect any pricing gains to be modest. The Chinese log market continues to be influenced by increased supply of lower priced, beetle impacted logs from Europe. We expect the log market in China to remain competitive over the near term. In the short term, the coronavirus could result in a temporary slow down of log and lumber imports to China. However, a government commitment to housing and continued positive economic growth should support long-term demand for logs and lumber in China.

We expect domestic saw log prices to increase in response to reduced log availability and improving lumber markets. Log supply on the BC coast is expected to remain constrained, as recent government initiatives that have increased harvest costs are expected to challenge harvest economics.

We expect modest improvements in pulp log and chip pricing in 2020 due to limited supply.

### *Strategic Capital Program*

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

Given the challenging operating environment on the BC coast, in part due to the uncertainty around BC government policies, we have scaled back our capital investment plans. Until there is an improved operating environment or greater clarity on the impact of BC government policies, the Company has reduced strategic capital investment in BC.

We will continue to evaluate opportunities to invest strategic capital in jurisdictions that create opportunity to grow long-term shareholder value.

### *Softwood Lumber Dispute and US Market Update*

The US application of duties continues a long-standing pattern of US protectionist action against Canadian lumber producers. We disagree with the inclusion of specialty lumber products, particularly WRC and Yellow Cedar products in this commodity lumber focused dispute. As duties paid are determined on the value of lumber exported, and as our shipments to the US market are predominantly high-value, appearance grade lumber, we are disproportionately impacted by these duties. For a comprehensive history of the softwood lumber trade dispute and related North American Free Trade Agreement (“NAFTA”) challenge proceedings, please see “*Risks and Uncertainties – Softwood Lumber Dispute*”.

Western expensed \$27.8 million of export duties in 2019, comprised of CVD and AD at a combined rate of 20.23% on all lumber it sold into the US. On February 3, 2020, the US Department of Commerce (“DoC”) issued preliminary revised rates in the CVD and AD first administrative review of shipments for the years ended December 31, 2017 and 2018. The combined preliminary revised rates were 8.37% for 2017 and 8.21% for 2018. The DoC may revise these rates between preliminary and the final determination expected in August 2020. Cash deposits continue at the current rate of 20.23% until the final determinations are published, at which time the 2018 rate will apply to US-destined lumber sales.

At December 31, 2019, Western had \$90.9 million of cash on deposit with the US Department of Treasury in respect of these softwood lumber duties.

Including wholesale lumber shipments, our sales to the US market represent approximately 27% of our total revenue in 2019. Our distribution and processing centre in Arlington, Washington and our Columbia Vista division in Vancouver, Washington are expected to partially mitigate the damaging effects of duties on our products destined for the US market. We intend to leverage our flexible operating platform to continue to partially mitigate any challenges that arise from this trade dispute.

## Non-GAAP Measures

Reference is made in this MD&A to the following non-GAAP measures: Adjusted EBITDA, Adjusted EBITDA margin, and Net debt to capitalization. These measures are used to our operating results relative to our competitors. These non-GAAP measures are commonly used by securities analysts, investors and other interested parties to evaluate our financial performance. These non-GAAP measures do not have any standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other issuers. The following table provides a reconciliation of these non-GAAP measures to figures as reported in our audited annual consolidated financial statements:

(millions of Canadian dollars except where otherwise noted)

	Q4 2019	Q4 2018	Q3 2019	Annual 2019	Annual 2018
<b>Adjusted EBITDA</b>					
Net income (loss)	\$ (29.2)	\$ 5.3	\$ (18.7)	\$ (46.7)	\$ 69.2
Add:					
Amortization	12.4	9.9	9.2	45.4	40.2
Changes in fair value of biological assets, net	1.4	0.4	(1.4)	2.3	(0.1)
Operating restructuring items	2.1	(0.4)	0.3	3.5	4.8
Other (income) expense <sup>(1)</sup>	2.8	0.9	(0.7)	2.9	1.1
Finance costs	2.2	0.7	1.9	7.8	2.7
Current income tax expense (recovery)	(3.4)	-	(9.6)	(13.0)	14.3
Deferred income tax expense	(6.6)	1.2	2.6	(3.7)	11.3
Adjusted EBITDA	\$ (18.1)	\$ 18.0	\$ (16.6)	\$ (1.5)	\$ 143.5
<b>Adjusted EBITDA margin</b>					
Total revenue	\$ 80.1	\$ 284.8	\$ 141.6	\$ 807.7	\$ 1,196.7
Adjusted EBITDA	(18.1)	18.0	(16.6)	(1.5)	143.5
Adjusted EBITDA margin	-22.6%	6.3%	-11.7%	-0.2%	12.0%
<b>Net debt to capitalization</b>					
Net debt					
Total debt, net of deferred financing costs	\$ 113.4	\$ 6.0	\$ 112.0		
Cash and cash equivalents	(2.1)	(8.4)	(5.1)		
Net debt (cash)	\$ 111.3	\$ (2.4)	\$ 106.9		
Capitalization					
Net debt (cash)	\$ 111.3	\$ (2.4)	\$ 106.9		
Add: Equity	481.8	572.9	519.1		
Capitalization	\$ 593.1	\$ 570.5	\$ 626.0		
Net debt to capitalization	18.8%	-	17.1%		

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

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

## Critical Accounting Estimates

### Reforestation Obligation

Under BC law, we are responsible for reforesting areas that we harvest. These obligations are referred to as reforestation obligations. We accrue our reforestation obligations based on estimates of future costs at the time the timber is harvested. The estimate of future reforestation costs is based on a detailed analysis for all areas that have been logged and includes estimates for the extent of reforestation versus natural regeneration, the cost of planting including the cost of seedlings, the extent and cost of site preparation, brushing, weeding, thinning and replanting and the cost of conducting surveys. Our registered professional foresters conduct the analysis that is used to estimate these costs. However, these costs are difficult to estimate and can be affected by weather patterns, forest fires and wildlife issues that could impact the actual future costs incurred and thus result in material adjustments.

### *Valuation of Inventory*

We value our log and lumber inventories at the lower of cost and net realizable value. We estimate net realizable value by reviewing current market prices for the specific inventory items based on recent sales prices and current sales orders. If the net realizable value is less than the cost amount, we will record a write-down. The determination of net realizable value at a point in time is generally both objective and verifiable. However, changes in product prices can occur suddenly, which could result in a material write-down in inventories in future periods.

### *Valuation of Accounts Receivable*

We record an allowance for the collection of doubtful accounts receivable based on our best estimate of potentially uncollectible amounts. The best estimate considers past experience with our customer base and a review of current economic conditions and specific customer issues. The Company's general practice is to insure substantially all North American lumber receivables for 90% of value with the Export Development Corporation, while all export sales are sold on either a cash basis or with secured instruments, which reduces the Company's exposure to bad debts.

### *Pension and Other Post Retirement Benefits*

Western has various defined benefit and defined contribution plans, and a group RRSP that provide retirement benefits to most of its salaried employees. A group RRSP is provided to certain hourly employees not covered by forest industry union plans. The Company also provides other post-retirement benefits and pension bridging benefits to eligible retired employees. Our defined benefit plans were closed to new entrants effective June 30, 2006. No further benefits accrue under these plans for years of service after December 31, 2010, and no further benefits accrue under these plans for compensation increases effective December 31, 2016. We retain independent actuarial consultants to perform actuarial valuations of plan obligations and asset values, and advise on the amounts to be recorded in the financial statements. Actuarial valuations include certain assumptions that directly affect the fair value of the assets and obligations and expenses recorded in the financial statements. These assumptions include the discount rate used to determine the net present value of obligations, the return on plan assets used to estimate the increase in the plan assets available to fund obligations, and medical and health care costs used to estimate obligations. Actual experience can vary materially from the estimates and impact the cost of our pension and post-retirement medical and health plans and future cash flow requirements.

### *Environmental Provisions*

We disclose environmental obligations when known and accrue costs associated with the obligations when they are known and can be reasonably estimated. The Company owns a number of manufacturing sites that have been in existence for significant periods of time and, as a result, we may have unknown environmental obligations. However, until the sites are decommissioned and the plant and equipment are removed, a complete environmental review cannot be undertaken.

### *Contingencies*

Provisions for liabilities relating to legal actions and claims require judgements using management's best estimates regarding projected outcomes and the range of loss, based on such factors as historical experience and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known.

### *Valuation of Biological Assets*

The Company values its biological assets at fair value less costs to sell. Valuation analysis includes recent comparatives of standing timber sales, direct and indirect costs of sustainable forest management, net present value of future cash flows for standing timber and log pricing assumptions. Significant assumptions are used in the preparation of the valuation and actual results may vary materially from estimates.

### *Impairments*

Assets that are subject to amortization are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment losses are recognized in net income for the period for the amount by which the asset's carrying amount exceeds its recoverable amount. An impairment analysis requires the use of significant assumptions, including management and independent third-party input.

### *Income Tax Assets and Liabilities*

Estimations in the recognition of tax assets or liabilities require assessments to be made based on the potential tax treatment of certain items that will only be resolved once finally agreed with the relevant tax authorities. Significant judgment is required as income tax laws and regulations can be complex and are potentially subject to different interpretation between the Company and the respective tax authority. Net income in subsequent periods may be impacted by the amount that estimates differ from the final tax return.

### *Deferred Income Taxes*

Deferred tax assets and liabilities comprise the tax effect of temporary differences between the carrying amount and tax basis of assets and liabilities, as well as the tax effect of unused tax losses. Assumptions underlying the composition of deferred tax assets and liabilities include estimates of future results of operations and the timing of reversal of temporary differences as well as the substantively enacted tax rates and laws at the time of the expected reversal. The composition of deferred tax assets and liabilities is reasonably likely to change from period to period due to the number of variables associated with the differing tax laws and regulations across the jurisdictions in which the Company operates. As a result, the precision and reliability of the resulting estimates are subject to uncertainties and may change as additional information becomes known. Uncertainties surrounding these assumptions and changes in tax rates or tax policy could have a material effect on expected results.

## **Accounting Policies and Standards**

Please refer to Note 2 and 10 of our audited annual consolidated financial statements for the year ended December 31, 2019 for further information on the accounting standards referenced below.

### *New Accounting Standards*

The Company has adopted IFRS 16, *Leases* ("IFRS 16"), with a date of initial application of January 1, 2019, using a modified retrospective approach. Under the modified retrospective approach, the cumulative effect of initial application has been recognized in retained earnings at January 1, 2019, and comparative information has not been restated and continues to be reported under IAS 17, *Leases*.

On transition to IFRS 16, the Company elected to apply a practical expedient to grandfather the assessment of which transactions are leases. IFRS 16 only applies to contracts that were previously recognized as leases. Contracts that were not recognized as leases under IAS 17 were not reassessed for whether there is a lease. As such, the definition of a lease under IFRS 16 was applied only to contracts entered into or changed after January 1, 2019.

As a result of the adoption of IFRS 16, the Company recorded right of use assets ("ROU assets") and lease liabilities of \$17.0 million as at January 1, 2019. During the year ended December 31, 2019, the Company recognized amortization of \$4.8 million in operating income and finance costs of \$0.8 million relating to these ROU assets and lease liabilities. The adoption of IFRS 16 had no impact on the overall cash flow of the Company.

### *Accounting Standards Not Yet Applied*

A number of new and amended IFRS standards are not yet effective for the year ended December 31, 2019 and have not been applied in preparing these financial statements. None of the standards are currently considered by the Company to be significant or likely to have a material impact on future financial statements.

## Financial Instruments and Other Instruments

Western has a program in place to reduce the impact of volatile foreign exchange rates on its net income. The Company utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange risk. Therefore, Western may purchase foreign exchange forward contracts or similar instruments to hedge anticipated USD and Japanese Yen (“JPY”) sales. The Company does not utilize derivative financial instruments for trading or speculative purposes. Western will consider whether to apply hedge accounting on a case by case basis and if the instrument is not designated as a hedge, the instrument is adjusted to fair value and marked to market each accounting period, with changes recorded in net income.

During 2019, the Company entered into foreign exchange forward contracts to sell USD and JPY in order to partially mitigate its foreign currency risk. At December 31, 2019, the Company had forward contracts in place to sell an aggregate USD \$12.0 million (2018: USD \$62.3 million; JPY 155.0 million). A net gain of \$0.7 million was recognized on contracts that matured during year (2018: net loss of \$5.1 million), which is included in sales in the consolidated statement of comprehensive income.

## Off-Balance Sheet Arrangements

Other than short-term and low-value leases for which recognition exemptions are applied under IFRS 16, the Company does not have any off-balance sheet arrangements as at December 31, 2019.

## Related Party Transactions

Key personnel of the Company include the executive management team and members of the Board of Directors. The compensation paid or payable to key personnel is shown below:

	Years ended December 31,	
	2019	2018
Salaries, directors' fees and short-term benefits	\$ 4.5	\$ 7.2
Post-employment benefits	0.4	0.3
Share-based compensation, including mark-to-market adjustment	(1.2)	2.7
	<u>\$ 3.7</u>	<u>\$ 10.2</u>

## Risks and Uncertainties

The following risks and uncertainties may have a material adverse effect on our operations or our financial condition:

### *Employees and Labour Relations*

Hourly paid employees at our Canadian manufacturing facilities, timber harvesting operations and a small group of clerical employees are unionized. The majority of the unionized employees are represented by the USW, which holds two collective agreements with the Company, one of which expired mid-June 2019 and which Western has been in negotiations with the USW since April 2019 for a new collective agreement. We applied to the BC Labour Relations Board (“Labour Relations Board”) on June 25, 2019 for the appointment of a mediator to assist in negotiations.

The USW served seventy-two hours’ notice of strike action on the Company and some of its contractors on June 28, 2019, and on July 1, 2019, the USW commenced the Strike. The Strike is ongoing for all of our USW certified manufacturing and timberlands operations. The Strike is also indirectly impacting certain non-USW certified manufacturing operations, including our Ladysmith sawmill (due to insufficient log supply) and our Value-Added remanufacturing facility (due to a lack of lumber supply). Our US based Arlington and Columbia Vista divisions continue to operate, although our Arlington facility is operating on a reduced basis due to a lack of lumber supply caused by the Strike.

Upon receiving strike notice from the USW, we commenced our work stoppage contingency plan with a goal to protect our balance sheet while mitigating the impact of the Strike on our Company, customers and business partners.

On September 4, 2019, we announced the expectation to begin mediation between the Company and USW with an independent mediator on September 13, 2019. The independent mediator was agreed to by both the Company and the USW but was not appointed by the Labour Relations Board. On September 13, 2019, the USW withdrew from the mediation after several hours of talks, and the mediators informed the Company that the USW would not be returning for talks scheduled for September 14, 2019. On October 17, 2019, we announced that the Company and USW were set to resume talks with the mediators. However, on October 31, 2019, we announced that no further mediation dates had been scheduled and we requested that the USW join us in binding arbitration in order to resolve the dispute.

After resuming talks, the Company announced on November 18, 2019 that active negotiations were no longer occurring and that no future mediation dates had been scheduled. On December 10, 2019, we announced that the Company and USW were set to resume talks with the mediators. However, on December 17, 2019, we announced that negotiations had reached an impasse and no future mediation dates had been scheduled.

On February 4, 2020, the Company announced that the independent mediators had withdrawn from the mediation process as they saw no basis for a negotiated settlement at the time.

On February 6, 2020, the BC Minister of Labour appointed Special Mediators to work with the Company and USW for a period of 10 days to determine if a negotiated settlement could be reached. On February 10, 2020, the Company announced that terms of a tentative collective agreement had been reached. The tentative agreement is subject to a ratification vote by USW membership. The USW bargaining committee has advised that they will be recommending its members accept the agreement.

A separate collective agreement with the USW covering 4 office clerical employees expired December 31, 2019. The Pulp, Paper & Woodworkers of Canada ("PPWC") represents the remaining unionized employees of the Company. The PPWC collective agreement for the Ladysmith Sawmill (82 employees), expired on December 31, 2019. The PPWC also represents the unionized employees at our Value-Added Remanufacturing Operation (86 employees) with whom the collective agreement expires October 14, 2021. Contract negotiations for the expired USW clerical and PPWC agreements have not commenced and are pending resolution to the Strike. Should the Company be unable to negotiate an acceptable contract for the USW clerical and PPWC collective agreements a strike or lockout could occur.

Continuation of the Strike, or a strike or lockout relating to one of our other collective agreements, could create significant disruption of operations, may affect our ability to meet the immediate needs of our customers, or could have an adverse material impact on our financial condition. Furthermore, a negotiated settlement could result in unplanned increases in wages or benefits payable to unionized employees.

In addition, the Company relies on certain third parties, such as logging contractors, stevedores, trucking companies and railways, whose workforces are unionized, to provide the Company with services necessary to operate the business. If those workers/employers engage in a strike or lockout, our operations could be disrupted.

### *Regulatory Risks*

Our forestry and sawmill operations are subject to extensive federal, provincial, state, municipal and other local laws and regulations, including those governing forestry, exports, taxes, labour standards, occupational health, safety, waste disposal, building structures/systems, environmental protection and remediation, protection of endangered and protected species and land use and expropriation. Under certain laws and regulations, we are also required to obtain permits, licences and other authorizations to conduct our operations, which permits, licences and authorizations may impose additional conditions that must be satisfied. Although we budget for expenditures to maintain compliance with such laws, permits and authorizations, there can be no assurance that these laws and regulations or government policy will not change in the future in a manner that could have an adverse effect on our financial condition or results of operations or the manner in which we operate. Nor can there be any assurance that administrative interpretation of existing laws and regulation will not change or more stringent enforcement of existing laws will not occur, in response to changes in the political or social environment in which we operate or otherwise, in a manner that could have an adverse effect on our financial condition or results of operations or the manner in which we operate.

Log exports from our timber operations are subject to federal and provincial regulations. An export permit must be obtained from the Canadian Federal Government to export any logs harvested in BC and generally the logs must be surplus to the supply required for domestic manufacturers. Logs from private timberlands that were granted by the Crown prior to March 12, 1906 are subject to the Federal surplus test and logs from private land granted after that date are subject to the Provincial surplus test. Logs harvested from Crown land in BC are subject to the Provincial surplus test. The regulations also restrict the species and grade permitted for export.

Under both the federal and provincial surplus tests, the logs must be advertised for local consumption. Logs are declared surplus and may be exported if there are no offers on the advertised logs by domestic manufacturers. In practice, domestic offers on export volume can be satisfied with replacement volume to minimize operational impacts. However, a substantial increase in domestic demand may adversely impact timber operations as export pricing is generally at a premium to domestic pricing.

There have been significant legislative reforms in the BC Forest Industry over the last 40 years. One of the more significant examples of this was seen in 2003 when the Province took back approximately 20% of the Allowable Annual Cut (“AAC”) from major license holders, including Western, and provided monetary compensation in return. There can be no assurance that the Province will not implement further policy changes, or that such changes will not have a material adverse effect on our operations or our financial position.

In 2018, the Province introduced a Coastal Revitalization Initiative and further policy initiatives that will affect the BC forest sector regulatory framework. On January 17, 2019, the Premier announced the Province’s commitment to make changes to BC’s export, Bill 13 and waste policies with the intent to increase domestic and value-added manufacturing in BC. On April 1, 2019, the Province announced the creation of fibre recovery zones, which are intended to increase the supply of residual fibre from primary harvesting for secondary users. Western estimates that approximately 70% of our timberland operations will be impacted with the creation of fibre recovery zones. The impacts to our business include the potential for higher costs and lower log harvest volumes. The Province has been clear that it does not want to see unintended consequences from the policy implementation. We continue to collaboratively engage with the Province and other stakeholders to ensure that the desired outcome of the policy, less fibre waste and more fibre for domestic manufacturing and pulp production, is met without the unintended consequences of higher costs and less harvest volume for timberland operators.

On April 11, 2019, the Province announced Bill 22, *Forest Amendment Act, 2019*, which came into force on May 30, 2019. The amendments to the *Forest Act* will require tenure holders to receive approval from the Minister before disposing or transferring a tenure agreement to a third party. These amendments will enable the Minister to refuse to approve, or place conditions on the approval of, a disposition or transfer if it is deemed not to be in the public interest or detrimental to competition in the buying or selling of timber or residuals.

On May 16, 2019, Bill 21, *Forest and Range Practices Amendment Act, 2019*, designed to increase opportunities for public input, improve information sharing on forest planning, strengthen the Minister’s ability to manage forest activity, expand the definition of wildlife to help protect at-risk species and improve and streamline range-use planning was put into force.

On July 10, 2019, the Province announced the application of a targeted fee-in-lieu of manufacturing for exported logs harvested from BC Timber Sales, as a step towards ensuring that more logs are processed in BC.

On July 17, 2019, the Province announced that a two-person panel had been appointed to lead an Old Growth Strategic Review and provide a report to the Minister of Forests, Lands, Natural Resource Operations and Rural Development. The panel will report back to government in spring 2020 with recommendations that are expected to inform a new approach to old-growth management for BC.

On November 28, 2019, Bill 41, Declaration on the Rights of Indigenous Peoples Act came into force. The Act is intended to guide the implementation of the principles of the UNDRIP and makes BC the first province in Canada to legally implement UNDRIP. The Act requires the Provincial Government to align all laws with UNDRIP, to develop an action plan to achieve this, and regularly report to the legislature to monitor progress. The current Federal Government has also pledged to implement UNDRIP and the Calls to Action of the Truth and Reconciliation Commission. Significant expectation has been raised among Aboriginal groups in BC and across the country as to the impact that this Act and the Federal Government's commitments may have on efforts to achieve true reconciliation with Aboriginal groups. At this time, the Company is unable to predict the outcome of the Act and the implementation of these commitments on Western's ongoing operations or on any sale of its non-core assets and private lands.

In December 2019, the BC Minister of Forests, Lands, Natural Resource Operations and Rural Development indicated a delay in expanding the fee-in-lieu payment for raw log exports to all cutting permits on the BC Coast by six months and indicated shrinking the penalties and zones for fibre recovery zones. Specific details of these policies changes have not been disclosed.

In January 2020, the Province announced changes to the Manufactured Forest Products Regulation effective July 1, 2020 to ensure more accessibility to fibre for local manufacturers. The regulation amendments require timber that is made from WRC or cypress (yellow cedar) to be fully manufactured to be eligible for export. Fully manufactured is defined as timber that will not be kiln-dried, planed or re-sawn at a facility outside of BC.

The impact that these policy initiatives and prospective policy initiatives or regulatory changes may have on our operations cannot be determined at this time.

In addition, Western is subject to litigation incidental to our business, the outcome of which we do not anticipate will have a materially adverse effect on our financial condition and results of operations.

### *First Nations Land Claims*

First Nations groups have made claims of rights and title to substantial portions of land in BC, including areas where our timber tenures and operations are situated. These claims of rights and title have created uncertainty as to the status of competing property rights and of legislation and Crown decisions that may adversely affect such asserted rights and title. The Supreme Court of Canada (the "Court") has held that Aboriginal groups may have a spectrum of constitutionally recognized and affirmed Aboriginal rights and title in lands that have been traditionally used or occupied by their ancestors; however, such rights or title are not absolute and may be infringed by government in furtherance of a valid legislative objective, including forestry, subject to meeting a justification test. The effect on any particular lands will not be determinable until the nature of historical use, occupancy and rights in any particular piece of property have been clarified. The Court has also held that even before claims of rights and title are proven, the Crown has a legal duty to consult with First Nations, which can become a duty to seek possible accommodations, when the Crown has knowledge, real or constructive, of the potential existence of an Aboriginal right or title and contemplates conduct that might adversely impact it. During the period before asserted claims are proven, the Crown is required to consult in good faith with the intention of substantially addressing First Nation concerns, but agreement by the First Nation is not required in these consultations.

First Nations are seeking compensation from governments (and in some instances from forest tenure holders) with respect to these claims, and the effect of these claims on timber tenure rights, including our timber tenures, cannot be estimated at this time. The Federal and Provincial Governments have been seeking to negotiate treaty and/or other settlements with Aboriginal groups in BC in order to resolve these claims. This section provides an overview of recent developments in First Nations land claims and settlements that have or may affect the Company.

In June 2014, the Court released its decision on the Aboriginal title claim by the Tsilhqot'in Nation of BC, regarding land outside their traditional reserve area. The Court recognized Tsilhqot'in title to a portion of the area in dispute, including rights to decide how the land will be used, occupancy and economic benefits of the land. The Court held that while the Province had the constitutional authority to regulate forest activity on Aboriginal title lands, it had not adequately consulted with the Tsilhqot'in. While the decision does not directly impact Western's business as we do not have tenure in this area, we do operate on Crown tenures elsewhere that are subject to claims of Aboriginal title. The potential impact on Western's tenure holdings is not ascertainable at this time.

On April 1, 2011, the first modern treaty affecting the Company's tenures was brought into force. The Maa-nulth First Nations Treaty extinguished the Company's tenure rights on Maa-nulth Treaty Settlement Lands within TFL 44 and permanently reduced the tenure's AAC by 95,200 cubic metres. A treaty provision which created a new Protected Area inside of TFL 44 permanently reduced the AAC by another 8,800 cubic metres.

The Company concluded discussions with the Province on the magnitude of the treaty impacts on AAC, soft cost investments and downstream business in 2016. On October 21, 2016, the Company announced that the Province of BC had agreed to compensate Western in the amount of \$14.0 million for the partial tenure extinguishment.

In January 2017, the Nuchatlaht First Nation filed a Notice of Civil Claim against Canada, the Province of BC and the Company, seeking a declaration of Aboriginal title to a claim area that encompasses the northern half of Nootka Island. The claim area encompasses The Company's Forest Licence A19231 and certain timber licences held by the Company. Each of the Province, Canada and the Company have filed a response to the Notice of Civil Claim and a case management judge has been appointed to oversee the proceedings. In December 2017, the Nuchatlaht First Nation filed an Amended Notice of Civil Claim that included significant changes to their original claim, and each of Canada, the Province and the Company then filed amended responses to Nuchatlaht's Amended Notice of Civil Claim. Since that time, little progress has been made toward advancing the case as the Province and Nuchatlaht have been engaged on a number of substantive and procedural issues.

On May 30, 2018, Western and several other parties, including Canada, the Province, Interfor, Marine Harvest and Cermaq, were served with a Notice of Civil Claim by the Dzawada'enuxw First Nation. The First Nation, located at Kingcome Inlet on the mainland coast, is seeking a declaration of Aboriginal title over an area that includes two Western Timber Licenses and TFL 39 block 3. The claim is unique in that the First Nation seeks a declaration of title over a marine area as well as land, and appears to have been strategically filed in advance of the Province making a decision on renewal of fish farm tenures in the Broughton Archipelago area. Dzawada'enuxw's legal counsel has agreed to not require Western to file a Response to Civil Claim at this time.

In November 2019, the Wei Wai Kum First Nation filed a petition with the BC Supreme Court against the Province of BC regarding its decision to offer the Company a replacement tenure for TFL 25. The Wei Wai Kum First Nation claim that the Province did not adequately consult and sufficiently accommodate them in relation to the Province's decision to offer a replacement tenure. Wei Wai Kum First Nation's counsel has granted the Province and Western an extension to the period of time to respond to the Petition and no fixed time limit has been set at this time.

In July 2013, the Ehattesaht First Nation filed a petition with the BC Supreme Court against the Province of BC regarding a decision of the Crown on the amount of unharvested volume in TFL 19 from the 2007 to 2011 cut control period. The Ehattesaht claimed the Crown did not adequately consult them about the decision and that additional volume must be made available to them based upon their asserted territory, rights, and economic interests. In 2014, the court ruled in favor of the Ehattesaht requiring further consultation on unharvested volume. In 2016, the Province advised Western that it would be awarding the unharvested volume, through separate forest licences, to the Ehattesaht and Mowachaht/Muchalaht First Nations. In order to minimize the potential impact of these new licences on its ongoing operations in TFL 19, Western continues to engage with the Ehattesaht and Mowachaht/Muchalaht First Nations to find mutually beneficial solutions.

In January 2008, the Ditidaht First Nation commenced litigation in the BC Supreme Court against the Province of BC, Canada, certain other First Nations and two forestry companies, including Western, seeking amongst other things declarations of aboriginal title and rights in areas of Vancouver Island that include areas covered by timber tenures held by the Company and declarations that provincial forestry legislation and the Company's timber tenures are of no force or effect on the claimed aboriginal title lands. In March 2013, Ditidaht and the BC Government entered an Incremental Treaty Agreement (the "ITA") which included Ditidaht agreement to not initiate or proceed with litigation against the Crown for land dispositions and land use authorizations during the term of the ITA, subject to the Province complying with consultation processes established under existing provincial policies and procedures. Consequently, unless the ITA is terminated in accordance with its provisions, this litigation will not be further pursued by Ditidaht.



































































































## Western Forest Products Inc.

DEFINING A HIGHER STANDARD™

Suite 800  
1055 West Georgia Street  
Royal Centre, PO Box 11122  
Vancouver, British Columbia  
Canada V6E 3P3  
Telephone: 604 648 4500

[www.westernforest.com](http://www.westernforest.com)  
[info@westernforest.com](mailto:info@westernforest.com)

Trading on the TSX as “WEF”