



Western Forest Products Inc.

2012 Annual Report

Financial Highlights

<i>(millions of dollars except where noted)</i>	Year ended December 31		
	2012	2011 ⁽⁵⁾	2010 ⁽⁵⁾
Revenue	\$ 925.4	\$ 853.7	\$ 667.9
Net income	\$ 29.1	\$ 23.8	\$ 31.2
Cash flow from operating activities	\$ 57.7	\$ 43.7	\$ 38.1
Basic and diluted net income per share (dollars)	\$ 0.06	\$ 0.05	\$ 0.07
EBITDA ⁽¹⁾	\$ 50.6	\$ 61.6	\$ 37.0
Weighted average common and non-voting shares outstanding ('000)	468,051	467,571	467,571
Working capital	\$ 120.0	\$ 123.7	\$ 109.0
Total assets	\$ 606.3	\$ 608.3	\$ 618.0
Net debt ⁽²⁾	\$ 15.0	\$ 52.1	\$ 99.8
Net debt to capitalization ⁽³⁾	0.04	0.13	0.23
Total liquidity ⁽⁴⁾	\$ 185.1	\$ 112.1	\$ 84.6

(1) See page 4 for definition of EBITDA. A quantitative reconciliation between net income and EBITDA can be found in Appendix A to the Management's Discussion and Analysis.

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

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

(4) Total liquidity comprises cash and cash equivalents and available credit under the Company's revolving credit facility and revolving term loan.

(5) Figures for 2011 and 2010 have been restated to reflect the accounting policy change with respect to the costing of log inventories from the distributed cost method to the average cost of production method on January 1, 2012.

Letter to Shareholders

To Our Shareholders,

A strong operating performance and improved lumber markets allowed Western to deliver the highest sales in Company history. Log and lumber sales increased as we continued to profitably grow our business to meet market demand. We delivered \$50.6 million of EBITDA and continued to make significant improvements to our balance sheet. Our net debt is now at an all-time low of \$15.0 million and our liquidity improved to \$185.1 million by year end, ensuring we are well positioned to continue to reinvest in our business and consider other capital allocation alternatives to enhance long term value for shareholders.

2012 financial highlights are as follows:

- EBITDA for the year was \$50.6 million
- Net debt decreased to \$15.0 million, a record low for Western
- Year-end liquidity improved by \$73.0 million to \$185.1 million
- Sales were \$925.4 million, the highest in Western's history

The year resulted in several operational achievements as we continue to grow the business:

- Medical Incident Rate improved by 11%, as we ended the year below 2.0
- Our margin improvement program gained traction and delivered \$8 million
- Log sales increased by 6%
- Lumber sales increased by 11%
- Manufacturing mill productivity per shift improved 8%

We are pleased to announce the appointment Don Demens as President and Chief Executive Officer of the Company, effective immediately. Don was instrumental in helping us turn around the business and his knowledge of our industry has been critical in defining our long-term strategy at Western. The Board is confident his leadership will continue to strengthen Western's position as a globally competitive forest products business.

Our outlook for lumber is positive as we transition from a supply-driven market to a demand-driven market. We are seeing improvements in global lumber markets, prompted by a substantial improvement in the U.S. housing market. Housing starts increased by 27% in 2012 and are forecast to grow by an additional 25% in 2013. As the U.S. attracts more supply to meet this growing demand, lumber pricing becomes more competitive. This is an excellent opportunity for Western.

Japanese lumber demand has improved, supported by government stimulus and what appears to be the beginning of the tsunami rebuild. With improved demand at home, U.S. exporters are offering fewer logs and less lumber to the Japanese market. This trend is providing an opportunity for Western to increase exports of many of our high-quality, high-value lumber products.

China's demand for logs and lumber products rebounded in late 2012 after excess inventories were eliminated. The Chinese government has reaffirmed its commitment to a large-scale housing program that will support a continued demand for lumber. China will have to compete globally for log and lumber supply, providing opportunities for Western's products.

Western's business plan for 2013 is focused on increasing lumber production to meet rising demand. The improved log and lumber markets are creating an opportunity for Western to increase margins as we utilize fully our flexible manufacturing base to refine our product mix between markets and product lines.

Investing in our manufacturing base enhances our ability to meet market demand with improved margins. We expect to see the first benefits of our capital plan in the first quarter of 2013 as the first phase of the Saltair upgrade nears completion. In addition, we are making progress on the development of auto-grading equipment for coastal species which, once developed, will be the first

installation of its kind on the coast of B.C. We will be bringing forward additional capital investment projects in coming months.

Our balance sheet improved significantly in 2012. We refinanced our debt and made progress on selling non-core assets. This positioned us to continue to pursue our strategic capital plan while considering other options to maximize shareholder value.

Investments in safety and training are also key components of our plan. Our safety performance has improved, led by our manufacturing group, which finished the year with the best safety results in company history, but more work needs to be done. We launched two new training programs - Logger and Faller Training - to enhance safe work practices for employees joining the B.C. coastal forest industry. We also made steady progress improving the safety in our timberlands operations.

We look forward to improved financial results in 2013 as lumber markets improve world-wide. We continue to build our business based on the positive contributions of the Western team. Our balance sheet is strong, our capital investments are becoming operational and we have done all this while improving our safety performance.

I would like to take the opportunity to thank our shareholders, employees and communities for their continued support of Western Forest Products.



Dominic Gammiero
Chairman



Lee Doney
Vice Chairman

Management's Discussion & Analysis ("MD&A")

The following discussion and analysis reports and comments on the financial condition and results of operations of Western Forest Products Inc. ("Company", "Western", "us", "we", or "our"), on a consolidated basis, for the year ended December 31, 2012 to help security holders and other readers understand our Company and the key factors underlying our financial results. This discussion and analysis should be read in conjunction with the audited annual consolidated financial statements and related notes thereto, for the years ended December 31, 2012 and 2011.

The Company has prepared the financial information contained in this discussion and analysis in accordance with International Financial Reporting Standards ("IFRSs"), as issued by the International Accounting Standards Board.

Reference is made in this MD&A to EBITDA¹. EBITDA is defined as operating income prior to operating restructuring items and other income (expenses), plus amortization of property, plant, equipment and intangible assets, impairment adjustments, and changes in fair value of biological assets. Western uses EBITDA as a benchmark measurement of our own operating results and as a benchmark relative to our competitors. We consider 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 EBITDA is commonly used by securities analysts, investors and other interested parties to evaluate our financial performance.

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

This MD&A contains statements which constitute forward-looking statements and forward-looking information within the meaning of applicable securities laws. Those statements and information appear in a number of places in this document and include statements and information regarding our current intent, belief or expectations primarily with respect to market and general economic conditions, future costs, expenditures, available harvest levels and our future operating performance, objectives and strategies. Such statements and information may be indicated by words such as "estimate", "expect", "anticipate", "plan", "intend", "believe", "should", "may" and similar words and phrases. Readers are cautioned that it would be unreasonable to rely on any such forward-looking statements and information as creating any legal rights, and that the statements and information are not guarantees and may involve known and unknown risks and uncertainties, and that actual results and objectives and strategies may differ or change from those expressed or implied in the forward-looking statements or information as a result of various factors. Such risks and uncertainties include, among others: general economic conditions, competition and selling prices, changes in foreign currency exchange rates, labour disruptions, natural disasters, relations with First Nations groups, changes in laws, regulations or public policy, misjudgments in the course of preparing forward-looking statements or information, changes in opportunities and other factors referenced under the "Risk Factors" section in our MD&A in this annual report. All written and oral forward-looking statements or information attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements. Except as required by law, Western does not expect to update forward-looking statements or information as conditions change.

¹ Earnings Before Interest, Tax, Depreciation and Amortization

Unless otherwise noted, the information in this discussion and analysis is updated to February 21, 2013. Certain prior period comparative figures have been reclassified to conform to the current period's presentation. All financial references are in millions of Canadian dollars unless otherwise noted.

Overview

Western's business continued to grow in 2012 with revenue reaching \$925.4 million, an increase of \$71.7 million, or 8%, from the prior year. The increase in sales revenue in 2012 was the result of higher shipment volumes for both lumber and logs and higher lumber prices. We generated EBITDA of \$50.6 million in 2012, a decline of \$11.0 million from the prior year. The reduced result was primarily due to the weakness in world pulp markets which led to lower selling prices for our pulp logs and by-products. In addition, we realized lower selling prices for export logs and we incurred higher log costs during 2012 as a result of difficult weather conditions. Partially offsetting these factors was the benefit of a positive change in the mix of our log sales in 2012. Proportionately more logs were sold in the domestic and export markets, and relatively fewer lower priced pulp logs were sold. Importantly, productivity at our sawmills in 2012 continued to improve as lumber production volume increased by 8% over 2011, while capacity utilization was flat year on year.

Our net income of \$29.1 million in 2012 was an increase of \$5.3 million over our 2011 net income of \$23.8 million. Following an impairment assessment of our timber licenses undertaken at the end of 2012, the Company partially reversed a previously recognized impairment by \$12.9 million in the fourth quarter of 2012 (see Note 5 to the 2012 Annual Financial Statements for further details). Excluding this item our net income in 2012 fell by \$7.6 million compared to 2011.

Finance costs in 2012 were lower than 2011 by \$1.6 million, or 24%, as a result of lower debt levels and lower interest rates. Selling and administration costs were higher in 2012 by \$2.4 million, as a result of increased employee costs and contractor services, but as a percentage of revenues there was no change year-on-year.

As part of the Company's strategic capital plan, Western announced a \$38.0 million investment in the Saltair sawmill in February 2012. This project will increase lumber production capacity by approximately 15%, improve lumber recovery and lower our unit cost of production while improving our ability to meet customer needs. The first phase of the project, which will be completed by the end of the second quarter of 2013, will see the replacement of the existing board edgers, trimmer, stacker, and a rebuild of the sorter.

In July 2012, Western announced that it would invest in the development of automated lumber grading technology for coastal species, as a second project in its strategic capital plan. We have committed to an initial investment of \$0.5 million for the development of automated lumber grading technology, with the first installation occurring in our Alberni Pacific Division planer mill in Port Alberni, BC. The equipment is expected to deliver significant increases in operating speeds, improve lumber grades, and increase lumber recoveries. We anticipate the project to be operating by the third quarter of 2013.

In June 2012, Western announced an agreement to refinance its existing revolving term loan facility with improved terms. Under the terms of the refinanced revolving term loan agreement, availability on Western's existing \$75.0 million revolving term loan was increased to \$110.0 million. In addition, pricing for the revolving term loan improved, and the maturity of the facility is now June 29, 2016. At December 31, 2012, Western's total liquidity had increased to \$185.1 million from \$112.1 million at the end of 2011. The increase of \$73.0 million was the result of increasing the revolving term facility from \$75.0 million to \$110.0 million, paying off debt with the proceeds of non-core asset sales, cash generated from operations, and increased availability in our secured revolving credit line.

Also in June 2012, Western sold Tree Farm Licence 60 ("TFL 60") and related assets on Haida Gwaii to Taan Forest Limited Partnership ("Taan"), a partnership of the Council of the Haida Nation and Haida Enterprise Corporation, the business arm of the Haida Nation. Under the terms of the sale, we received net proceeds of approximately \$12.2 million. Cash of \$10.2 million was received, and the remaining \$2.0 million is in the form of a promissory note, payable within 24 months of closing. Western also retains a right of first refusal on a certain quantity of cedar logs harvested by Taan over

the 24 months following closing. Taan has assumed substantially all of the obligations of Western on Haida Gwaii. As the average timber harvest from TFL 60 by Western over the past five years has been modest, the sale of this tenure will have minimal impact on the long-term operating rates at our eight lumber mills. Proceeds from the sale were used to pay down the Company's revolving term debt.

In December 2012, the Company and Brookfield Special Situations Management Limited ("BSSML") closed a bought deal secondary offering (the "Offering") through which BSSML sold 62,500,000 Non-Voting Shares of Western at an offering price of \$1.20 per share for aggregate gross proceeds to BSSML of \$75.0 million. On closing of the Offering, the shares were converted, on a one-for-one basis, into Common Shares of Western, representing approximately 33% of the then issued and outstanding Common Shares of Western on a non-diluted basis after giving effect to the Offering. Immediately following completion of the Offering, 59,612,801 of the remaining Non-Voting Shares held by BSSML were converted into Common Shares on a one-for-one basis. As at December 31, 2012, BSSML beneficially held 122,639,345 Common Shares, or 48.82% of the Company's 251,218,424 Common Shares, and 100% of the 216,833,059 Non-Voting Shares issued and outstanding. This represents the same percentages of Common Shares and Non-Voting Shares that BSSML held prior to the Offering.

In January 2013, Western announced that it had entered into a conditional agreement for the sale of its former Woodfibre Pulp Mill site for a gross purchase price of \$25.5 million. The site, consisting of 212 acres of industrial waterfront land, is located at the head of Howe Sound, southwest of Squamish, British Columbia. Closing is subject to certain conditions, and Western will be responsible for the satisfactory remediation of the property to applicable environmental standards prior to closing the sale. After incurring the estimated required remediation costs, Western anticipates receiving net proceeds from the sale and remediation of approximately \$17 million.

As economic and other circumstances allow, Western will continue to pursue opportunities to sell non-core assets.

Selected Annual Information ⁽¹⁾

Financial Highlights

	Year ended December 31		
	2012	2011 ⁽²⁾	2010 ⁽²⁾
<i>(millions of dollars except per share amount)</i>			
Revenue	\$ 925.4	\$ 853.7	\$ 667.9
EBITDA	50.6	61.6	37.0
EBITDA as % of revenue	5.5%	7.2%	5.5%
Operating income prior to restructuring items and other income (expenses) ⁽⁴⁾	37.3	35.0	30.5
Net income from continuing operations	30.2	24.9	32.7
Net income	29.1	23.8	31.2
Basic and diluted earnings per share	\$ 0.06	\$ 0.05	\$ 0.07
Total assets	\$ 606.3	\$ 608.3	\$ 618.0
Net debt ⁽³⁾	\$ 15.0	\$ 52.1	\$ 99.8

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

(2) Figures for 2011 and 2010 have been restated to reflect the accounting policy change with respect to the costing of log inventories from the distributed cost method to the average cost of production method on January 1, 2012.

(3) Net debt is the sum of long-term debt, current portion of long-term debt and the revolving credit facility, less cash and cash equivalents.

(4) Figures for 2012 and 2010 include \$12.9 million and \$18.5 million, respectively, for reversals of impairment

Continuing Operations

Revenue

(millions of dollars)	Year ended December 31	
	2012	2011
Lumber	\$ 624.4	\$ 561.1
Logs	246.3	231.6
By-products	54.7	61.0
Total revenue	<u>\$ 925.4</u>	<u>\$ 853.7</u>

Lumber revenue in 2012 was \$63.3 million, or 11%, higher than in 2011. Western shipped 894 million board feet of lumber ("mmfbm") in 2012, which was up 10% from the 811 mmfbm shipped last year. Markets began the year with relatively weak demand, but United States ("US") housing starts began accelerating through the year. As US demand improved we experienced better pricing for both our western red cedar ("WRC") and commodity segments. We believe that the Japanese and Chinese markets had accumulated excess inventories in the first half of 2012 which they needed to reduce and, as a result, demand in those markets did not begin improving until the fourth quarter of 2012.

Overall average prices per board foot of lumber sold in 2012 were marginally higher than 2011. This result masks the upward trend in pricing which did not gain momentum until the latter part of the year. Increased lumber demand in the US helped move pricing up in WRC and commodity lumber starting late in the third quarter of 2012. Prices in Japan started moving up in the fourth quarter of 2012, but prices in our niche segment remained flat. We expect these trends to continue through to the second quarter of 2013.

In 2012, our overall 10% increase in shipments reflected higher volumes to Canada, the US and Japan, which was partially offset by lower volumes to China, Europe and Australasia. Rising North American lumber demand and pricing is providing higher margin opportunities in the commodity segment of our business.

Our lumber sales volume into Canada increased by 31% over 2011 levels to 370 mmfbm, with the majority of the increase being driven by higher hemlock sales. Our hemlock sales increased, particularly in the commodity sector, as higher levels of housing activity drove more business for pressure treated lumber. We also continue to develop new markets in the industrial and civil construction sectors to take further advantage of our ability to make larger sizes with the strength properties inherent in our coastal species.

Our lumber shipments to the US were 16% higher in 2012, driven by stronger demand for WRC. New home construction starts in the US, while still below historic trend levels, accelerated in 2012. New home construction in the US grew by 28% in 2012 over 2011 levels, with the multifamily construction sector growing by 40%.

Lumber shipments to Japan for 2012 increased by 4% over 2011 levels to 185 mmfbm, primarily due to increased yellow cedar shipments. Average prices realized on these shipments were 5% higher in 2012. Rebuilding required as a result of the tsunami, which devastated Japan early in March 2011, has not yet had a significant impact on demand. Japanese demand was flat through the first three quarters of 2012, and began to trend up in the last quarter. Two factors increased the demand for Western's lumber in Japan in the latter part of the year; housing demand increased due to Japanese government stimulus programs and the start of the tsunami rebuild; and secondly, improved US markets has meant less lumber has been available for the export markets.

Our direct lumber shipments to China decreased by 10% in 2012 to 182 mmfbm. However, this reduction is not indicative of reduced shipments to China in general since we are now selling more volume locally to take advantage of wholesale markets, which in turn is selling much of this on to China. However, the market growth in China did slow down, and much of this was attributable to the fact that the market had high log and lumber inventories at a time when the Chinese government was

taking steps to slow down housing growth. Inventory levels were reduced by mid-year and market demand began to strengthen in the latter part of 2012, yielding higher price levels.

Log sales in 2012 increased by \$14.7 million over 2011. The overall average price of logs sold in 2012 was marginally higher than in 2011. Domestic log prices were higher in 2012 compared to 2011 by 5%, on average, and overall log sales volumes were 8% higher in 2012 compared to 2011. However, market prices for pulplogs and export logs declined by 12% and 8%, respectively, from 2011 levels. Tempering the negative impact of these price declines has been a favourable change in sales mix, with relatively fewer pulplogs and more export logs sold this year.

Sales of by-products in 2012 were \$54.7 million, or \$6.3 million lower than in 2011. The majority of our by-products sales are comprised of chip sales, and in 2012 we sold 9% more volume compared to 2011. Despite increased sales volumes of by-products, revenue declined by 10% as a result of an 18% reduction in overall average prices in 2012 compared to 2011. In general, chip prices are tied by a formula to the market price of pulp, and for 2012 these prices were lower than 2011 (NBSK prices delivered to China were 23.5% higher in 2011 than in 2012). Western has various obligations under long-term chip supply contracts which require us to either purchase quantities of chips on the open market or use whole log chipping programs at certain of our sawmills or third party chipping facilities, if insufficient chips are produced from our own mills.

Total freight costs incurred in 2012 were \$88.2 million which is \$2.6 million less than those incurred for 2011. Log shipment freight costs were \$3.6 million lower in 2012 compared to 2011 while lumber freight costs were \$1.0 million higher. The log freight costs were reduced primarily because more log shipments were sold on a FOB basis in 2012. In the case of lumber, while shipment volumes for 2012 increased by 10% over 2011, freight costs increased by just \$1.0 million, or 1%. The primary reason for this is that market conditions in 2012 led Western to pursue higher margin opportunities in local markets, which meant proportionately more of its lumber sales were shipped locally and less in overseas markets (China in particular), which have significantly higher freight rates. In 2012, 55% of our shipments were in North American markets compared to 47% in 2011. In addition, transportation management initiatives have helped to reduce costs in key markets by approximately \$1.5 million in 2012.

EBITDA

EBITDA for 2012 was \$50.6 million, which is a decline of \$11.0 million from the \$61.6 million achieved in 2011. Lumber production for 2012 was 8% higher than during 2011. Our sawmills operated at 84% of total capacity in 2012 compared to 83% of capacity in 2011. The increased production level was achieved with almost the same number of shifts being operated over the two years which reflects increased operating efficiencies at our mills as indicated by an 8% improvement in total board feet of lumber produced per shift.

With the increased growth in production, unavoidable fixed costs associated with curtailed activities for our logging and sawmill facilities that were directly expensed to the income statement in 2012 declined from \$8.6 million in 2011 to \$4.2 million in 2012.

Even though we continued to increase production and sales levels of both lumber and logs in 2012, our EBITDA declined mainly as a result of lower market prices for our pulplogs and export logs, lower by-product pricing, and higher log costs. Partially offsetting these negative variances was a favourable change in the sales mix of our logs as described above, higher domestic log sales prices, increased sawmill productivity, higher realized lumber prices, freight cost reductions, and lower fixed costs associated with less down time.

The total log harvest for 2012 was 6.1 million cubic meters, which was 5% higher than the 2011 harvest level of 5.8 million cubic meters. As we increased the harvest from all of our tenures, we increased our heli-logging harvest and incurred additional transportation costs. However, offsetting the higher logging costs was a higher value species mix of logs resulting from the increased heli-logging. The higher log costs also included more purchased logs and proportionately more of these purchases were higher cost cedar and hemlock sawlogs to supplement our sawmill demand. Finally, we incurred higher maintenance costs in our timberlands operations in 2012.

The impact of foreign currency had a slightly negative impact on our results for 2012 compared to 2011, mainly attributable to the strengthening Canadian dollar against the Japanese Yen.

Selling and administration expenses in 2012 were \$29.0 million (2011 - \$26.6 million). The \$2.4 million increase is largely because of increases in employee related costs and contractor services. As a percentage of revenues our selling and administration costs were 3.1% for 2012, which is consistent with 2011.

Reversal of impairments

During 2012, Western recorded a reversal of previously recognized impairments of \$12.9 million on its Crown timber tenures. This resulted from a value in use assessment performed in December 2012 on the carrying amount of the Crown tenures. The reversal was the result of increases to the net present values of projected cash flows generated from the tenures, primarily due to the beneficial impact of using a lower discount rate compared to that used in 2011.

Operating restructuring items

In 2012, Western recorded restructuring expenses of \$4.8 million compared to an equivalent expense of \$0.7 million in 2011. The majority of the expense in 2012 related to \$4.0 million incurred to restructure harvesting operations in TFL44 in order to improve operating performance in the future. The balance of \$0.8 million related to severance costs incurred with respect to departmental reorganizations. The restructuring charges in 2011 of \$0.7 million primarily related to severance costs associated with restructuring of certain administrative functions.

Finance costs

Finance costs for 2012 of \$5.0 million were \$1.6 million less than the \$6.6 million incurred in 2011. The decrease was primarily caused by lower average debt levels outstanding in 2012 compared to 2011, resulting from the proceeds of non-core asset sales and cash generated from operations being used to pay down debt in 2012. Also contributing to this reduction is the benefit of lower negotiated interest rates in our loan agreements.

Other income (expenses)

Other income of \$2.8 million was reported in 2012 which is a net change of \$5.6 million from the expense of \$2.8 million incurred in 2011. The most significant items comprising other income of \$2.8 million in 2012 were: net gains on non-core asset disposals in the year of \$1.1 million; proceeds of \$1.1 million received as final compensation from the Province of British Columbia resulting from the creation of new protective areas in our Haida Gwaii and Central Coast operating areas; \$0.9 million received as reimbursement for engineering and other infrastructure costs associated with an area that was deleted from TFL 39 in order to provide the Sliammon First Nation with a Treaty related forest tenure opportunity; and \$0.3 million related to other miscellaneous expenses.

Other expenses of \$2.8 million in 2011 comprise: a gain on the sale of an equity interest in certain real estate properties of \$2.4 million; an expense incurred of \$2.5 million to secure amendments to the terms of certain contractual arrangements; and losses on non-core asset sales of \$2.7 million. The most significant non-core asset sale in the year was the sale to TimberWest Forest Corp. of 7,678 hectares of land located in the southern portion of Vancouver Island near Jordan River for gross proceeds of \$21.9 million.

Income taxes

At December 31, 2012, the Company and its subsidiaries had unused non-capital tax losses carried forward totaling approximately \$393.4 million, which expire between 2025 and 2032, and can be used to reduce taxable income. In addition, the Company has capital losses of approximately \$124.4 million, which are available indefinitely, but can only be utilized against capital gains. Although the Company expects to realize the full benefit of the loss carry forwards and other deferred tax assets, due to economic conditions over the last several years, these losses have not been recognized as tax assets.

Net income from continuing operations

Net income from continuing operations in 2012 increased by \$5.3 million to \$30.2 million from the prior year figure. If the net impairment reversal of \$12.9 million is excluded, net income from continuing operations is \$7.6 million lower this year. This reduction is primarily comprised of a reduction in EBITDA of \$11.0 million as discussed above, higher restructuring costs of \$4.1 million, which is partially offset by an increase in other income of \$5.6 million, and lower finance costs of \$1.6 million.

Discontinued Operations

Operations of the site of the former Squamish pulp mill were discontinued in 2006. Since that date, the Company has expensed costs for supervision, security, property taxes and environmental remediation. In 2012, the Company incurred costs of \$1.1 million with respect to the site which is the same as that expensed in 2011. We are pursuing the sale of energy generated from the hydro electrical generating plant at the site, and it is anticipated that this will commence in May of 2013, and is expected to largely offset the maintenance costs incurred on the site. We continue to assess the site for further opportunities to develop existing hydro potential, leveraging our infrastructure in place at the site. Western announced on January 28, 2013 that it has entered into a conditional sale agreement for the site (as described in the "Overview" section above).

Financial Position and Liquidity

	Year ended December 31	
	2012	2011
(millions of dollars)		
Cash provided by operating activities	\$ 57.7	\$ 43.7
Cash provided by (used in) investing activities	(15.1)	11.9
Cash used in financing activities	(38.0)	(44.3)
Cash used to construct capitalized logging roads	(11.1)	(8.7)
Cash used to acquire property, plant, and equipment	(20.9)	(10.7)

	December 31	December 31
	2012	2011 ⁽⁴⁾
Total liquidity ⁽¹⁾	\$ 185.1	\$ 112.1
Net debt ⁽²⁾	15.0	52.1
Non-current financial liabilities	33.8	58.5
Financial ratios:		
Current assets to current liabilities	2.30	2.30
Net debt to capitalization ⁽³⁾	0.04	0.13

(1) Total liquidity comprises cash and cash equivalents and available credit under the Company's revolving credit facility and revolving term loan.

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

(3) Capitalization comprises net debt and shareholders equity.

(4) Figures for 2011 have been restated to reflect the accounting policy change with respect to the costing of log inventories from the distributed cost method to the average cost of production method on January 1, 2012.

Cash provided by operating activities in 2012 amounted to \$57.7 million, an increase of \$14.0 million over the \$43.7 million provided in 2011. Cash generated by operating activities before working capital changes was \$42.0 million, which was \$18.4 million less than that generated in 2011, primarily reflecting the lower EBITDA generated in the current year. However, more than offsetting this reduction was the \$32.4 million positive swing in cash generated from working capital changes over the respective periods. This is largely driven by a significant reduction in inventory levels at the end of

2012 compared to the start of the year, and compared to 2011 when the inventories increased over the year. Inventories of both logs and lumber fell at the end of 2012 as a result of high shipments in the latter part of the fourth quarter of 2012.

Net cash of \$15.1 million was used in investing activities in 2012, which compares to a net \$11.9 million generated in 2011. The difference relates to the reduced level of cash received from non-core asset sales in 2012, which at \$16.9 million was \$14.4 million less than was received in 2011, and also to the higher capital spending in 2012. Our capital expenditures in 2012 were \$32.0 million, which compares to \$19.4 million spent in 2011. The increase reflects \$8.1 million invested during 2012 in our strategic projects which are now underway, and also higher spending in both our capital maintenance projects and road building programs. Our strategic capital spend in 2012 was primarily related to the Saltair sawmill stacker, edger and trimline projects. The strategic capital program is discussed more fully in the "Outlook and Strategy" section.

Financing activities in 2012 used cash of \$38.0 million compared to \$44.3 million in 2011. Western repaid \$24.3 million of net long-term debt in 2012 compared to \$47.1 million in 2011. In addition, the amount of \$8.9 million drawn on the revolving credit facility at the end of 2011 was repaid in 2012. The repayment of long-term debt in 2012 was lower than in 2011 primarily because there were fewer non-core asset sales in the current year. In 2011, these sales included the Jordan River properties located in the southern part of Vancouver Island which were sold to TimberWest Forest Corp. for gross proceeds of \$21.9 million. Interest paid in 2012 was \$4.0 million compared to \$6.0 million paid in 2011, mainly as a result of lower outstanding debt levels and lower interest rates in 2012.

At December 31, 2012, Western's total liquidity had increased to \$185.1 million from \$112.1 million at the end of 2011. The increase of \$73.0 million was the result of increasing the revolving term facility from \$75.0 million to \$110.0 million, paying off debt from the proceeds of non-core asset sales and cash generated from operations, and increased availability in the secured revolving credit line. Liquidity is comprised of cash of \$18.8 million and unused availability under the secured revolving credit line of \$91.1 million and \$75.2 million under the revolving term loan.

Based on our current forecasts, we expect sufficient liquidity will be available to meet our obligations in 2013.

Fourth Quarter Results

	Three months ended December 31	
	2012	2011 ⁽¹⁾
<i>(millions of dollars except per share amount)</i>		
Revenue	\$ 231.2	\$ 220.7
EBITDA	14.2	11.6
EBITDA as % of sales	6.1%	5.3%
Operating income	15.8	4.9
Net income from continuing operations	14.8	3.6
Net income	14.6	3.3
Basic and diluted net income per share (in dollars)	0.03	0.01

(1) Figures for 2011 have been restated to reflect the accounting policy change with respect to the costing of log inventories from the distributed cost method to the average cost of production method on January 1, 2012.

We saw an overall improvement in market conditions in the fourth quarter of 2012. Historically, lumber prices decrease in the fourth quarter of the year as seasonal demand declines. However, North American commodity prices unexpectedly increased during the quarter, along with WRC prices. Japanese market demand also improved, and we anticipate pricing will improve as levels of housing activity continue to increase in Japan. Despite difficult logging conditions due to weather, we were able to meet customer lumber demand by improving productivity in our sawmills and drawing down our log and lumber inventories.

We reported EBITDA of \$14.2 million in the fourth quarter of 2012, an increase of \$2.6 million over the fourth quarter of 2011. The increased EBITDA results from higher sales volumes of lumber and higher average log and lumber selling prices.

Revenue was \$10.5 million, or 5%, higher in the fourth quarter of 2012 compared to the fourth quarter of 2011. Lumber and log revenues were both higher with a small decrease in by-products sales.

Lumber shipment volumes were 6% higher this quarter and selling prices at the mill net level were higher in the current quarter compared to a year ago, with WRC, hemlock and cypress all being higher. However, overall gross average prices received were marginally lower in this quarter compared to the fourth quarter 2011 because revenues used to determine average overall selling prices included foreign exchange gains of approximately \$2.0 million in the fourth quarter of 2011 with only a minor equivalent adjustment in the current quarter, and distribution costs were lower in the current quarter compared to the fourth quarter of 2011.

As we worked through our order file in the fourth quarter of 2012 we started to see the impact of rising global lumber prices. We did not see the significant increases in lumber prices that may have been expected given the surge in benchmark commodity prices over the fourth quarter of 2012. Part of the reason for this is the fact that our product prices are typically less volatile than commodity prices, and also because our order file is longer.

Log sales revenue in the fourth quarter of 2012 was \$2.7 million higher than the same quarter in 2011. While shipment volumes were 2% less in fourth quarter of 2012 compared to the same quarter in 2011, average prices realized were 6% higher. Most log species showed increased prices in the fourth quarter this year with the exception of pulplogs which were 8% lower. Also in the current quarter, we sold more high priced cypress sawlogs. By-product revenues were \$0.9 million lower this quarter compared to 2011, principally as a result of lower pulp prices.

Sawmill production in the fourth quarter of 2012 was marginally higher than the fourth quarter 2011, but with fewer shifts being run, which means that productivity per shift was 7% higher in 2012.

Timberlands harvest production volumes were the same for the two quarters. The cost of logs sold in the fourth quarter sales largely reflect different operating conditions in the third quarter of the respective years. In 2012, Western incurred higher log distribution costs in order to expedite log deliveries to meet demand pressures, partially caused by the low availability following late summer curtailments resulting from exceptionally hot and dry weather conditions. In contrast, fourth quarter 2011 costs benefitted from lower production costs due to favourable third quarter harvesting conditions. Partially offsetting the negative impacts of this, cost recoveries earned in timberlands in the fourth quarter of 2012 were \$3.0 million higher than the fourth quarter of 2011, as it included an insurance claim recovery for weather related damages, a Bill 13 contract settlement, and higher Forest License Use Agreement revenues.

Selling and administration expenses in the fourth quarter of 2012 were \$6.9 million, the same as in the fourth quarter of 2011. Operating restructuring items were \$4.4 million higher in the fourth quarter of 2012 than the same quarter of 2011. The primary reason for this is the inclusion in 2012 of \$4.0 million expensed as a result of restructuring harvesting operations in TFL 44 in order to improve its operating performance in the future.

For the fourth quarter of 2012, the Canadian dollar average exchange rate was 3% and 8% stronger relative to the USD and the Yen, respectively, compared to the rates for the fourth quarter of 2011. This had a negative effect on our earnings in the current quarter compared to the same quarter in 2011.

Other expenses in the fourth quarter of 2012 of \$0.9 million compares to other expenses of \$0.3 million in the fourth quarter of 2011. Included in the fourth quarter of 2012 was a net loss on non-core asset sales of \$1.5 million, partially offset by income of \$0.9 million received from the Province of British Columbia for costs incurred by Western relating to a First Nations treaty (Sliammon Treaty). Finance costs in the current quarter were \$1.0 million in the fourth quarter of 2012 which is \$0.4 million lower than the fourth quarter of 2011, primarily as a result of lower average debt levels in the current quarter.

Net income of \$14.6 million reported in the fourth quarter of 2012 was an \$11.3 million increase over the income of \$3.3 million reported for the same quarter of 2011. The difference was largely due to the 2012 income including an impairment reversal of \$12.9 million on our timber license valuation (as described earlier in this report). Excluding this item, the current quarter net income is \$1.6 million lower, and operating income \$2.0 million lower, than the fourth quarter of 2011.

Outlook and Strategy

During 2012, Western continued to build its improved financial condition by increasing the cash flows provided from operations. We have further strengthened our balance sheet, and significantly improved our liquidity. Our long term strategic goals for the Company remain:

- Fully utilizing our annual allowable cut and ensuring the highest margin end use for our fibre resource;
- Operating all our mills at full capacity, realizing full economies of scale;
- Growing market share in traditional and developing export markets; and
- Generating substantial free cash flow that justifies re-investment and further growth.

North American lumber markets are clearly showing signs of recovery and moving from being a predominantly supply driven market to one that is more demand driven, which is leading to price increases, particularly in commodity lumber products. Overall, we see a positive outlook for the majority of our business, with the possible exception of pulplogs and residual markets. Our business strategy continues to focus on growing our four key lumber market segments: Japan, WRC, Commodity, and Niche.

Japan is expected to increase its demand for wood products as housing starts are projected to rise as government stimulus and the Tsunami rebuild effort picks up pace. Additionally, the increased demand for wood products within the US will result in fewer log and lumber exports being available from the US to Japan. Western's sales to Japan are expected to grow in 2013, with the majority of the increase coming in yellow cedar sales.

Western continues to be the largest producer of WRC in the world, and is expanding its share of the US market. Demand for WRC in 2012 was better than expected, and with limited supply available, price levels increased. The outlook for 2013 remains similar to 2012 with supply growth being less than expected demand. Improving US new home construction and increasing levels of US home renovation support the increased demand for WRC in 2013. Cedar pricing remained uncharacteristically strong through the end of 2012 and prices for 2013 are projected to increase through the peak demand season in the first half of the year.

The unseasonal run-up in North American Commodity pricing in the last quarter of the year (as seen by the 12% increase in the benchmark kiln-dried SPF price in the fourth quarter) has impacted all commodity pricing, regardless of market destination. Western continues to use its market flexibility with respect to its commodity market segment, by increasing sales into a strong North American market. The US housing market has clearly regained its footing, although it is still at just half of trend levels. New housing starts were approximately 780,000 in 2012, an increase of 28% over the 2011 level. Conditions in the housing construction market have clearly improved and forecasters indicate a further 24% increase in 2013 to just under a million starts. The slowdown in the China market at the beginning of 2012 reversed in the third quarter and demand has steadily improved. We will continue to maintain our focus on margin for commodities, by shifting product and market mix to maximize margin.

Sales in the Niche market segment are forecast to remain stable in 2013, as the two main markets for these products, Europe and North America, remain challenging. The North American market for higher grade Douglas fir and hemlock products used in appearance applications has not seen the same recovery as in the general US housing market. The outlook for Europe, a high value market for Western, appears to be little changed from 2012, with recession concerns still an issue.

We continue to position ourselves for an improving housing market by investing \$125 million of strategic capital into the Company. The strategic capital plan supports our growth strategy, further enhancing our margins through improved efficiencies and product grades ensuring our continued

competitiveness in the global lumber markets. We expect that the strategic capital program will be funded by cash generated from operations. The capital can be broken down into three areas:

- Significant rebuilds in our small log mills implementing state-of-the-art breakdown, edging and sorting equipment to improve operating metrics and drive down costs;
- Installation of technology such as automated grading that was not available until recently for our specialty product lines; and
- Replacement and additions of key equipment in our large log mills to improve quality, recovery and product flexibility.

Our first project is the \$38 million upgrade of our Saltair sawmill which is designed to improve the mill productivity by 15% and to improve our competitiveness in key markets such as Japan, the United States and China. This first phase includes a full upgrade to the edgers, trimmer, sorter and stacker for the mill and will be complete at the end of the second quarter of 2013.

Our second project, an automated lumber grading project being installed at our Alberni Pacific sawmill is under development and will yield benefits later in 2013.

The remaining strategic capital investments, which will occur over the next two to three years, will be focused on reducing costs by improving efficiencies and product flexibility in our operations. These improvements will allow us to continue operating through varying market conditions. Such investments are expected to be funded from operating free cash flows.

Complementing our strategic capital investment program is our non-capital margin improvement program. This program is targeted to deliver an additional \$25 million in margin enhancements over the next three years through a variety of cost reduction and productivity initiatives across the organization. We have achieved approximately \$8.3 million of these benefits by the end of 2012, with the majority relating to manufacturing throughput improvements, logistics enhancements, and procurement initiatives.

We will continue to pursue further opportunities that may arise to sell non-core or other land assets as appropriate. Proceeds from such sales will first be directed to reduce or eliminate long-term debt with any surplus being used to provide additional liquidity.

Summary of Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2012 and our payments due for each of the next five years and thereafter:

<i>(millions of dollars)</i>	Total	2013	2014	2015	2016	2017	Thereafter
Accounts payable and accrued liabilities	\$ 74.0	74.0	-	-	-	-	-
Discontinued operations	7.8	5.1	2.2	0.1	0.1	0.1	0.2
Revolving term loan	34.8	-	-	-	34.8	-	-
Operating leases	16.8	3.1	2.9	2.3	1.9	1.3	5.3
Silviculture provision	31.0	13.4	4.9	3.0	2.0	1.5	6.2
Other long-term liabilities	0.7	0.3	0.1	0.1	0.1	0.1	-
Defined benefit pensions funding obligations	15.0	2.3	2.3	2.3	0.8	0.8	6.5
Total	\$ 180.1	\$ 98.2	\$ 12.4	\$ 7.8	\$ 39.7	\$ 3.8	\$ 18.2

Note: the payments above for discontinued operations relates to future estimated environmental costs to be incurred.

Critical Accounting Estimates

Silviculture Provision

Under British Columbia law, we are responsible for reforesting areas that we log. These obligations are called silviculture liabilities. We accrue our silviculture liabilities based on estimates of future costs at the time the timber is harvested. The estimate of future silviculture costs is based on a detailed analysis for all areas that have been logged and includes estimates for the extent of planting seedlings 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 silviculture 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 commodity 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 doubtful collection of 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 or Coface Canada, 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 that provide pension benefits to most of its salaried employees and certain hourly paid employees not covered by forest industry union plans. The Company also provides other post-retirement benefits and pension bridging benefits to eligible retired employees. With respect to the defined benefit plans (which were closed to new entrants in June, 2006 and effective December 31, 2010 no further benefits accrue under the plans), 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 the increase in future compensation amounts 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.

Environment

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 judgments 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.

Land Valuations

On adoption of IFRSs, we elected to measure land at fair value at each annual reporting date, or more frequently in the event of a material change in circumstances. This requires an assessment of the fair value of all land holdings using a combination of independent third party valuations, recent comparable land sales, discounted cash flow analysis as well as considering other publicly available information such as recent market transactions on arm's length terms between willing buyers and sellers, and British Columbia property assessments.

Valuation of Biological Assets

The Company values its biological assets at fair value less costs to sell. An annual valuation is performed by an independent third party based on recent comparatives of standing timber, 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. Impairment losses are recognized in net income for the period.

Changes in Accounting Policies

Inventories

On January 1, 2012, the Company changed its accounting policy with respect to the costing of log inventories from the distributed cost method to the average cost of production method. Under the new policy, the costs of logs produced carry an average cost of production based on the operation where the logs are produced, determined by actual log production costs divided by production volumes. This compares to the former policy which allocated costs based on the estimated fair value of the logs produced. Management believes that this change in accounting policy provides more relevant information about the financial performance of the Company to the users of the financial statements, as it aligns the costing methods of the Company's log and lumber inventories, and is more consistent with industry accounting practices and also results in a more conservative carrying value relative to the previous method used.

This change in accounting policy was applied retrospectively with prior periods being restated accordingly. The change resulted in a \$10.1 million reduction to the carrying value of inventory and a corresponding increase to the deficit as at December 31, 2011 (December 31, 2010: \$9.9 million). For the year ended December 31, 2011 the policy change resulted in an increase to cost of goods sold and a decrease to earnings of \$0.2 million from that previously reported.

Future Changes in Accounting Policies

New Standards and Interpretations

The following new or amended IFRSs have been issued which are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted, with the exception of IFRS 13 Fair Value Measurement which is effective prospectively from January 1, 2013, and IFRS 9 Financial Instruments which is effective for annual periods beginning on or after January 1, 2015:

IFRS 9 Financial Instruments
IFRS 10 Consolidated Financial Statements
IFRS 11 Joint Arrangements
IFRS 12 Disclosure of Interests in Other Entities
IFRS 13 Fair Value Measurement
Amendments to IAS 19 Employee Benefits
Amendments to IAS 28 Investments in Associates and Joint Ventures

IFRS 9 Financial Instruments (2009 and 2010) ("IFRS 9 (2009)" and "IFRS 9 (2010)") will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 (2009) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities.

IFRS 10 Consolidated Financial Statements ("IFRS 10") replaces the guidance in IAS 27 Consolidated and Separate Financial Statements ("IAS 27") and SIC-12 Consolidation – Special Purpose Entities ("SIC-12"). IAS 27 (2008) survives as IAS 27 (2011) Separate Financial Statements, only to carry forward the existing accounting requirements for separate financial statements. IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are special purpose entities in the scope of SIC-12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 (2008).

IFRS 11 Joint Arrangements ("IFRS 11") replaces the guidance in IAS 31 Interests in Joint Ventures ("IAS 31"). Under IFRS 11, joint arrangements are classified as either joint operations or joint ventures. IFRS 11 essentially carves out of previous jointly controlled entities those arrangements, which although structured through a separate vehicle, such separation is ineffective and the parties to the arrangement have rights to the assets and obligations for the liabilities and are accounted for as joint operations in a fashion consistent with jointly controlled assets/operations under IAS 31. In addition, under IFRS 11 joint ventures are stripped of the free choice of equity accounting or proportionate consolidation; these entities must now use the equity method. Upon adoption of IFRS 11, entities which had previously accounted for joint ventures using proportionate consolidation shall collapse the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented. The investment's opening balance is tested for impairment in accordance with IAS 28 (2011) and IAS 36 Impairment of Assets. Any impairment losses are recognized as an adjustment to opening retained earnings at the beginning of the earliest period presented.

IFRS 12 Disclosure of Interests in Other Entities ("IFRS 12") contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), associates and/or unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvements that expose an entity to variability of returns from the performance of the other entity. The required disclosures aim to provide information in order to enable users to evaluate the nature of, and the risks associated with, an entity's interest in other entities, and the effects of those interests on the entity's financial position, financial performance and cash flows.

IFRS 13 Fair Value Measurement ("IFRS 13") replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs, the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRSs. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

IAS 19 Employee Benefits ("IAS 19") will modify accounting for pensions and other post-retirement and post-employment benefits and impact corporate financial reporting, including reported net profit. The key impacts of the amendments will include:

- Changes in how a plan's funded status and its variation during a reporting period will affect the statement of financial position and comprehensive income;
- Changes in the reported benefit expense due to the removal of the expected return on assets and amortization items;
- Significant changes to the footnote disclosures; and
- Potential implications for the way that plan sponsors manage defined benefit plan risk.

IAS 28 Investments in Associates and Joint Ventures ("IAS 28") will modify the existing standard as issued in 2008 as follows:

- Associates and joint ventures held for sale. IFRS 5 Non-current Assets Held for Sale and Discontinued Operations applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. For any retained portion of the investment that has not been classified as held for sale, the equity method is applied until disposal of the portion held for sale. After disposal, any retained interest is accounted for using the equity method if the retained interest continues to be an associate or a joint venture.
- Changes in interests held in associates and joint ventures. Previously, IAS 28 and IAS 31 specified that the cessation of significant influence or joint control triggered re-measurement of any retained stake in all cases with gain recognition in profit or loss, even if significant influence was succeeded by joint control. IAS 28 will be modified so that in such scenarios the retained interest in the investment is not re-measured.

These new and revised accounting standards have not yet been adopted by Western. The Company does not expect the implementation of these standards to have a material impact on its financial statements.

Financial Instruments, Off-Balance Sheet Arrangements, Foreign Exchange and Related Party Transactions

Financial instruments, which for Western consist primarily of debt instruments, are discussed elsewhere in this discussion and analysis.

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 sales to customers in the United States and Japan. 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 be fair valued and marked to market each accounting period, with changes recorded in net income.

To further assist in mitigating this foreign exchange risk, the Company entered into an agreement in March 2009 with Brookfield Asset Management Inc. ("BAM") to provide a foreign exchange facility ("Facility") to the Company. The Facility, which is for a notional amount of up to US\$80.0 million, matures on March 31, 2013, and allows for forward transactions with a maximum term for each transaction of up to one year. The maturity date is subject to automatic annual renewal subject to BAM notifying the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and to certain change of control provisions being invoked. The Facility is unsecured and is subject to a fee of 0.10% of the notional amount per annum. The Company does not consider the credit risk associated with this Facility to be significant. During 2012, the Company entered into contracts under the Facility to sell US dollars and Japanese Yen ("JPY") forward in order to mitigate a portion of this foreign currency risk. At December 31, 2012, the Company had forward contracts in place to sell US\$42.0 million and JPY 400 million (2011 – US\$2.0 million; JPY 4,050 million). A net loss of \$1.0 million was recognized on contracts which matured in the year (2011 - \$0.8 million), which is included in sales in the consolidated statement of comprehensive income.

Other than operating leases for vehicles, equipment and machinery, the Company does not have any off-balance sheet arrangements as at December 31, 2012.

In addition to the related party transactions identified elsewhere in this MD&A, the Company has or had certain arrangements with entities related to BAM to acquire and sell logs, lease certain facilities, provide access to roads and other areas, and acquire services including insurance, all in the normal course and at market rates or at cost. The following table summarizes these transactions:

Western made purchases from related parties as follows:

	Year ended December 31	
	2012	2011
Log purchases	\$ 11.5	\$ 13.5
Other	6.5	4.7
	<u>\$ 18.0</u>	<u>\$ 18.2</u>

Western received revenues from related parties as follows:

	Year ended December 31	
	2012	2011
Log sales	\$ 7.9	\$ 5.4
Other	-	2.4
	<u>\$ 7.9</u>	<u>\$ 7.8</u>

Related party liabilities at December 31, 2012 were \$0.1 million (December 31, 2011: \$1.7million)

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:

	Year ended December 31	
	2012	2011
Salaries and directors' fees	\$ 2.7	\$ 2.2
Post-employment benefits	0.2	0.2
Share-based payments	0.9	0.7
	<u>\$ 3.8</u>	<u>\$ 3.1</u>

Risks and Uncertainties

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

Variable Operating Performance, Product Pricing and Demand Levels

A key factor affecting Western's operating and financial performance is the price received for lumber, logs and other products. Prices for these products are highly cyclical and have fluctuated significantly in the past and may fluctuate significantly in the future. The markets for our products are also highly cyclical and are characterized by periods of excess product supply due to many factors, including:

- Additions/curtailments to industry capacity and production;
- Periods of insufficient demand due to weak general economic activity or other causes including weather factors;
- Customers experiencing reduced access to credit; and
- Inventory de-stocking by customers.

Product demand is influenced to a significant degree by economic activity at the global level. Additionally, although costs may increase, customers may not accept related price increases for those products. We are not able to predict with certainty market conditions and prices for our products. Western's results of operations depend upon the prices we receive for lumber, logs and chips, and deterioration in prices of, or demand for, these products could have a material adverse effect on our financial condition or results of operations. We cannot provide any assurance or prediction as to the timing and extent of any price changes. On an annualized basis and based on current operating metrics, we estimate that operating earnings would increase or decrease by approximately \$9 million for each incremental price increase or decrease, respectively, of \$10 per thousand board feet of lumber. Each incremental price swing greater than \$10 per thousand board feet of lumber is expected to have an impact on operating earnings of slightly less than \$7 million per increment due to the likely related change in stumpage fees.

Western's financial performance is also dependent on the rate at which production capacity is utilized. In times of challenging conditions in any of our major markets the Company maintains inventory control by aligning log supply and lumber production with anticipated sales volumes. When capacity utilization is reduced in response to weak demand for products, the cost per unit of production may increase and profitability decrease.

From time to time and in accordance with market influences, the Company will reduce production with temporary logging and/or sawmilling curtailments. In extreme cases, such curtailments may become permanent closures. When Western undertakes significant market-related curtailments of sawmills, the volume of chips produced is reduced and accordingly there is greater risk that the Company may not meet minimum contractual obligations under long-term chip supply agreements without incurring additional cost.

International Business and Risks of Exchange Rate Fluctuations

Western's products are sold in international markets. Economic conditions in those markets, especially the United States, Japan and China, the strength of the housing markets in the United States and Japan, fluctuations in foreign exchange rates and international sensitivity to interest rates, can all have a significant effect on our financial condition and results of operations. In general, our sales are subject to the risks of international business, including:

- fluctuations in foreign currencies;
- changes in the economic strength of the countries in which we conduct business;
- trade disputes;
- changes in regulatory requirements;
- tariffs and other barriers;
- quotas, duties, taxes and other charges or restrictions upon exports or imports;
- transportation costs and the availability of carriers of any kind including those by land or sea; and
- strikes or labour disputes in the transportation industry or related dock or container service industries.

Depending on product mix, destination and exchange rates, between 35% and 45% of our total product sales are denominated in US dollars and between 10% and 15% in JPY, while most operating costs and expenses are incurred in Canadian dollars, with small portions in US dollars and JPY. The Company's functional currency is the Canadian dollar and results of operations are reported in Canadian dollars. Significant variations in relative currency values, particularly significant changes in the value of the Canadian dollar relative to the US dollar, have had, and in the future could have, a material impact on our operating earnings and cash flows. We estimate that an increase or decrease of 1% in the value of the Canadian dollar compared to the US dollar and Japanese Yen would decrease or increase annual operating earnings by approximately \$3.9 million to \$4.3 million, and \$0.8 million to \$1.0 million, respectively.

The Softwood Lumber Agreement (“SLA”) with the United States was implemented on October 12, 2006. The agreement has a term of seven years, extendable for up to two years, and may be terminated after 18 months by either the Canadian or United States government with not less than six months’ notice. On January 23, 2012 Canada and the United States agreed on a two year extension of the SLA, which will now terminate in October, 2015. We are unable to predict whether the agreement will be terminated prior to expiration or the consequences upon termination, should it occur. In addition, the agreement provides that if the monthly volume of exports from the British Columbia coastal region exceeds a certain “Trigger Volume” as defined in the agreement, a “surge” mechanism will apply to increase the rate of the export tax for that month by 50% (for example, a 15% export tax rate would become 22.5% for that month). The surge mechanism can be triggered by any or all companies in the region over-shipping, causing total exports to exceed the trigger volume. We are unable to predict if or when the surge mechanism will apply to any of our future lumber shipments into the United States.

On January 18, 2011, the US initiated proceedings against Canada with the London Court of Arbitration under the SLA over its concern that the Province of British Columbia (“the Province”) has misapplied or altered its timber pricing rules and as a result has charged too low a price for certain timber harvested on public lands in the BC interior. In August, 2011, the US filed a detailed statement of claim with the arbitration panel. Canada delivered its initial response to the US claim in November 2011. On July 18, 2012, the arbitration panel dismissed in their entirety the claims of the United States that Canada and BC had misapplied its timber pricing practices and so circumvented the SLA.

The US Lumber Coalition (the “Coalition”) has claimed that the Province has been undercharging the coastal forestry industry for timber harvested on crown lands and is questioning the accuracy of BC’s Coast market pricing system (“MPS”). The Coalition has taken the issue to the office of the US Trade Representative (“USTR”), which has in turn written to the Ministry of Forests to enquire as to the status of the update of the Coast MPS. The Coast MPS was introduced in 2004 and updated in 2007 and 2009. There is no time requirement in the SLA as to when updates occur, however, on July 1, 2012 the Coast MPS was updated and, consistent with the Softwood Lumber Agreement, the USTR has been informed. As this complaint is in the preliminary stages of investigation, the existence of any potential claim has not been determined and no provision has been recorded in the financial statements as at December 31, 2012.

Employees and Labour Relations

Hourly paid employees at our manufacturing facilities, timber harvesting operations and a small group of clerical employees are unionized. Currently we negotiate and administer six collective agreements. Our unionized employees are represented by the United Steel Workers (“USW”) or the Pulp, Paper and Woodworkers of Canada (“PPWC”) or the Canadian Merchant Service Guild (“Guild”). The collective agreement covering the majority of Western’s unionized employees was renewed in 2010 and expires on June 14, 2014. Other collective agreements negotiated in 2010 include employees affiliated with the PPWC at the Company’s Ladysmith Sawmill Operation and Value Added Remanufacturing operation, USW Clerical and a Quatsino Dry Land Sort tug boat Captain who is affiliated with the Guild. These agreements expire on December 31, 2014, October 14, 2016, December 31, 2013 and September 30, 2015, respectively. In 2012, the collective agreement covering employees at the South Island Remanufacturing operation was renegotiated. The expiry date of the new agreement is May 22, 2017.

Should the Company be unable to negotiate an acceptable contract after any of these collective agreements expire with any of the unions, a strike or work stoppage could occur. Furthermore, a negotiated settlement could result in unplanned increases in wages or benefits payable to unionized employees. Therefore, a strike or other work stoppage could involve significant disruption of operations and/or a material adverse impact on our financial condition or results of operations. In addition, the Company relies on certain third parties, such as logging contractors, stevedores or major railways, whose workforces are unionized, to provide us with services needed to operate our business. If those workers engage in strikes or other work stoppages, our operations could be disrupted.

Long-Term Competition

The markets for our products are highly competitive on a domestic and international level, with a large number of major companies competing in each market. Many of our competitors have substantially greater financial resources than Western. We also compete indirectly with firms that manufacture substitutes for solid wood products, including non-wood and engineered wood products. While the principal basis for competition is price, we also compete to a lesser extent on the basis of quality and customer service. In addition, market acceptance of the environmental sustainability of our products as compared with substitutes could be a challenge in the future. Changes in the level of competition, industry capacity and the global economy have had, and are expected to continue to have, a significant impact on the selling prices of the Company's products and the overall profitability of the Company. Our competitive position will be influenced by factors including the availability, quality and cost of fibre, energy and labour, and plant efficiencies and productivity in relation to our competitors. Our competitive position could be affected by fluctuations in the value of the Canadian dollar relative to the US dollar and/or the JPY, and by the export tax on softwood lumber shipments to the US.

Forest Resource Risk and Natural Catastrophes

Our timber tenures are subject to the risks associated with standing forests, in particular, forest fires, wind storms, insect infestations and disease. Procedures and controls are in place to try and mitigate such risk through prevention and early detection. Most of the timber that we harvest comes from Crown tenures and insurance coverage is maintained only for loss of logs following harvesting due to fire and other occurrences. However, this coverage does not extend to standing timber, and there is no assurance that this coverage would be adequate to provide protection against all eventualities, including natural catastrophes. Western has entered into a cost-sharing agreement with the Crown for our private timberlands to reduce individual incident costs of mobilizing helicopters and aerial water tankers in the event of a fire on those lands.

In addition, our operations may be adversely affected by severe weather including wind, snow and rain that may result in our operations being unable to harvest or transport logs to our manufacturing facilities for extended periods of time. Although we anticipate and factor in a certain period of down-time due to weather, extended periods of severe or unusual weather may adversely impact our financial results due to higher costs and missed sales opportunities arising from fibre shortages or the deterioration of logs remaining on the ground or in the water for extended periods of time.

All of our business operations are located on the British Columbia coast, which is geologically active and considered to be at risk from earthquakes.

Climate change over time is predicted to lead to changes in the frequency of storm events as well as their severity. We also expect to see changes in the occurrence of wildfires and forest pest outbreaks. Long-term climatic models are predicting that the optimum ranges of many species, including those of our major tree species, will shift over time. We are unable to predict the impact of all of these factors on our tenures or on forest practices.

While the Company maintains insurance coverage to the extent deemed prudent by us, we cannot guarantee that all potential insurable risks have been foreseen or that adequate coverage is maintained against known risks.

Impact of Mountain Pine Beetle Infestation

The north-central interior forests of British Columbia and western parts of Alberta have been, and continue to be, seriously damaged by North America's largest recorded mountain pine beetle infestation. Western does not operate in the affected area and lodgepole pine, the species most at risk from the infestation, is not a key source of timber in the coastal forests. This natural disaster is causing widespread mortality of lodgepole pine. Increases in harvest levels in the affected areas of the interior of British Columbia have resulted in higher lumber production volumes and therefore more supply in the marketplace, potentially decreasing prices, primarily in the structural dimension market in the United States. There is growing evidence that, as the dead trees decay, they become more difficult and costly to manufacture into lumber and that the quality of the residual wood chips may diminish. There may also be access issues over time as developing second growth forests grow to a size that precludes efficient entry into remote pine beetle damaged stands.

The mountain pine beetle has crossed into Alberta, and timber harvesting of lodgepole and jackpine in Alberta may see an increase in Annual Allowable Cut ("AAC") to promote salvage before decay, potentially adding to downward price pressures as the lumber supply may increase. The Company is unable to predict when or if the mountain pine beetle infestation will be halted or its impact on future lumber, chip and log prices.

Pulp and Paper Market Variability

The selling price in Canadian dollars of our residual wood chips is tied by formula to published indices that reflect the selling price of NBSK pulp. Fluctuations in pulp prices and foreign currencies will accordingly impact the selling price of our residual wood chips. The price and demand for the pulp logs and other logs sold to pulp and paper companies is also dependent on the market conditions for pulp and paper. If there is a contraction in the coastal pulp and paper industry, we may need to find alternative customers for the pulp logs and residual chips from our sawmills.

Western has a material agreement to supply fibre to Catalyst Paper Corporation ("Catalyst"). On January 31, 2012, Catalyst announced that it had obtained an Initial Order from the Supreme Court of British Columbia under the Companies' Creditors Arrangement Act ("CCAA") to facilitate an orderly restructuring of its business and operations. Subsequently in 2012, Catalyst emerged from CCAA and completed the restructuring of its business. All of their Canadian pulp and paper facilities continue to operate. Western's agreement with them remains fundamentally unchanged.

Dependency on Fibre Obtained from Government Timber Tenures

Currently, substantially all of the timberlands in which we operate are owned by the Province and, until March 14, 2011 were administered by the Ministry of Forests, Mines and Lands as well as the Ministry of Natural Resource Operations. A second restructuring of provincial resource ministries within a year created the new Ministry of Forests, Lands and Natural Resource Operations ("MFLNRO"). The *Forest Act* (British Columbia) ("Forest Act") empowers the MFLNRO to grant timber tenures, including Tree Farm Licences ("TFLs"), Forest Licences ("FLs") and Timber Licences ("TLs"), to producers, although no new TLs can be issued and the availability of extensions to expiring TLs is not assured. The Provincial Chief Forester must conduct a review of the AAC for each Timber Supply Area and each TFL in the Province on a periodic basis, at least once every ten years. This review is then used to determine the AAC for licences issued by the Province under the Forest Act. Many factors affect the AAC such as timber inventory, the amount of operable forest land, growth estimates of young forests, regulation changes and environmental and social changes. Such assessments have in the past resulted and may in the future result in reductions or increases to the AAC attributable to licences held by British Columbia forest companies (without compensation), including the licences that we hold. In addition, our AAC can be temporarily reduced (without compensation for the first four years) in areas where logging has been suspended under Part 13 of the Forest Act pending further consideration in land use planning. Land use planning, including critical habitat designations as well as new harvesting regulations, can constrain access to timber and new parks can permanently remove land from the timber harvesting land base. There can be no assurance that the amounts of such future reductions on our licences, if any, will not be material or the amounts of compensation, if any, for such reductions will be fair and adequate.

Forest Policy Changes in British Columbia

There have been significant legislative reforms in the British Columbia 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 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.

First Nations Land Claims

First Nations groups have made claims of rights and title to substantial portions of land in British Columbia, including areas where our timber tenures and operations are situated, creating uncertainty as to the status of competing property rights and of legislation and Crown decisions that adversely affect such asserted rights and title. The Supreme Court of Canada 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 Supreme Court of Canada 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 First Nations agreement 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 settlements with aboriginal groups in British Columbia in order to resolve these claims. On April 1, 2011, the first modern treaty affecting the Company's tenures was brought into force. The Maa'nulth Treaty extinguished the Company's tenure rights on Maa'nulth Treaty Settlement lands within TFL 44 and permanently reduced the tenure's AAC by 95,200m³. A treaty measure which created a new Protected Area inside of TFL 44 permanently reduced the AAC by another 8,800m³. The Company is in discussions with the Province on the magnitude of the treaty impacts on AAC, improvements, soft cost investments and downstream business. As these discussions are ongoing, any settlement or the amounts of compensation that we would receive for this or future reductions of our tenures as a result of this process cannot be estimated at this time and none has been recorded as a receivable. Other treaty processes involving the Nam'gis, Sliammon K'omox and Wuikinuxv First Nations are also well advanced and may lead to agreements impacting Western in 2013. It is expected that through these and other treaty-related processes the Provincial Government will want to remove areas out of the Company's various forest tenures.

Current Provincial Government policy requires that forest management and operating plans take into account and not unreasonably infringe on aboriginal rights and title, proven or unproven, and provide for consultation with First Nations. This policy is reflected in the terms of our timber tenures, which provide that the MFLNRO may vary or refuse to issue cutting permits in respect of a timber tenure if it is determined by a court that the forestry operation would unreasonably interfere with aboriginal rights or title. First Nations have, at times, sought to restrict the Provincial Government from granting or replacing forest tenures and other operating authorizations or from approving forest management plans on Crown lands without full consultation and accommodation or their consent if these decisions could affect lands claimed by them. There can be no assurance that denial of required approvals for, or changes to the terms of our timber tenures, other operating authorizations or forest management plans as a consequence of such consultation or action will not have an adverse effect on our financial condition or results of operations.

An unfavourable result in any of the First Nations litigation in which the Company is a party or which involves assets of the Company could have a material adverse effect on our financial condition or results of operations. See also "*Legal Proceedings*".

Stumpage Fees

Stumpage is the fee that the Province charges forest companies for timber harvested from Crown land in British Columbia. More than 95% of the timber we harvest is from Crown land. In January 2004, the Provincial Government adopted a more open and competitive market pricing system for timber and logs for the coastal region. Previously, the amount of stumpage paid for each cubic metre of wood harvested from the coastal region was based on a target rate set by the Province. Since February 29, 2004, stumpage for the coastal region is being set using the Coast version of the MPS, which uses the results from British Columbia Timber Sales ("BCTS") auctions of standing timber to establish the value of Crown timber harvested under long-term tenures. Coastal MPS is updated on a routine basis to reflect current market conditions (including log prices, timber sale bids for example) and costs. The most recent update occurred on July 1, 2012.

There can be no assurance that future changes to the stumpage system or the Province's administrative policy will not have a material impact on the stumpage fees payable by us and consequently affect our financial condition and results of operations.

Long-term Fibre Supply Agreements

The Company has a number of long-term commitments to supply chip fibre, sawlogs and pulplogs to third parties. Certain of these fibre supply agreements have minimum volume requirements. A failure to supply the minimum volumes may result in additional costs or deferred obligations. In one case the failure to supply the minimum volume could result in the loss of a TFL, but with a concurrent reduction in the future fibre supply commitment under that agreement.

Safety

The Company's safety policy reflects its values and commitment to providing a healthy and safe workplace for its people, while at the same time ensuring compliance with our regulatory requirements under WorkSafeBC. Workplace safety laws and regulations change over time and may involve new methodologies and additional costs necessary to bring the Company into compliance.

Environmental Regulation

We are subject to extensive federal and provincial environmental laws and regulations. These laws and regulations impose stringent standards on our operations and impose liability to remedy problems for which we are legally responsible regarding, among other things:

- air emissions;
- land and water discharges;
- operations or activities affecting watercourses or the natural environment;
- operations or activities affecting species at risk;
- use and handling of hazardous materials;
- use, handling, and disposal of waste; and
- remediation of environmental contamination.

We may incur substantial costs to comply with current or future requirements, to respond to orders or directions made, to remedy or to compensate others for the cost to remedy problems for which we are legally responsible or to comply with new environmental laws that may be adopted from time to time. In addition, we may discover currently unknown environmental problems or conditions affecting our operations or activities or for which we are otherwise legally responsible. Western has closed certain operations and although we have engaged specialists to advise us of environmental problems and conditions, normal site clean-up may identify additional problems or conditions. Any such event could have a material adverse effect on our financial condition and results of operations.

Regulatory Risks

Our forestry and sawmill operations are subject to extensive federal, provincial, 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 and permits, 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.

Our timber operations are subject to federal and provincial restrictions that may require them to decrease planned export of logs. Currently, in British Columbia logs from most Crown lands are subject to Provincial log export restrictions and logs from most private timberlands are subject to Federal export regulations. As a result, all export logs must be of a species and grade permitted for export and advertised for local consumption and may be exported only if there is a surplus of domestic supply as indicated by the absence of fair market value offers (based on current domestic prices) from domestic lumber mills. Accordingly, an increase in domestic demand could result in our timber operations being required to decrease their planned export of logs. The provincial government in British Columbia is currently reviewing its log export policy, and may recommend that the federal government impose a policy that may further restrict the export of logs from private lands in British Columbia. As export market pricing is currently at a premium to the domestic market pricing, any substantial reduction in log exports could have an adverse effect on our timber operations.

Legal Proceedings

In January 2008, the Ditidaht First Nation commenced litigation in the BC Supreme Court against the Province of British Columbia, Canada, certain other First Nations and two forestry companies, including the Company, 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. This proceeding is in the early stages and no trial date has been set.

In April 2008, the Kwakiutl First Nation commenced litigation in the BC Supreme Court against the Province of British Columbia, Western and the federal government seeking, amongst other things, orders to set aside the Province's decision to remove Western's private lands from a TFL and the Province's approval of the Company's Forest Stewardship Plan on the Crown lands within their area of interest, based on alleged infringements of their treaty rights and unextinguished aboriginal title and rights. A preliminary application by the Province to restrict the scope of this litigation had been scheduled for January, 2010 but was adjourned at the request of the Kwakiutl First Nation. The Company and the governments filed their responses and affidavits in 2011 and the Kwakiutl have filed evidence with more expected to follow. Hearing dates are set for 2013.

In 2005, the Hupacasath First Nation obtained an order of the BC Supreme Court requiring the Province of British Columbia to consult with them regarding certain Crown decisions, including a 2004 decision of the Minister of Forests, Mines and Lands to remove private lands from TFL 44, a TFL subsequently acquired by the Company. In 2008 the Court ordered that a mediator be appointed to address appropriate accommodation for the effects of the Minister's 2004 private land decision upon the asserted aboriginal rights of the Hupacasath First Nation on their claimed territory, both with respect to the private lands that are now outside the TFL and the Crown lands that remain within the Company's TFL. The scope of this mediation is to include, among other things, consideration of possible accommodation from resources on the Crown lands remaining in the TFL now held by the Company. The Province continues to negotiate the terms to satisfy mediation that are likely to include a Government Actions Regulation Order for Thunder Mountain, new Old Growth Management Areas around Great Central Lake, and various new tenure awards to the Nation.

The Company is currently unable to predict the outcome of these First Nation legal proceedings on Western's ongoing operations or on any sale of its non-core assets and private forestry lands.

In addition, Western is subject to routine 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.

Reliance on Directors, Management and Other Key Personnel

Western relies upon the experience and expertise of our personnel. No assurance can be given that we will be able to retain our current personnel and attract additional personnel as necessary for the

development and operation of our business. Loss of or failure to attract and retain key personnel could have a material adverse effect on Western's business.

Change of Control of Western

BSSML, as manager for and on behalf of the Brookfield Capital Partners Fund I ("BCPI") (formerly the Brookfield Special Situations Fund I), controls 48.82% of the outstanding Common Shares of Western and holds an additional equity interest in Western through Non-Voting Shares. If a change of control of Western were to occur, there could be significant adverse consequences to Western. If it is determined that there has been an acquisition of control for Canadian tax purposes we may lose the benefit of historical tax losses, which may limit our ability to shelter future operating income from tax. In addition, if the MFLNRO were to be satisfied that any change or acquisition of control unduly restricted competition in standing timber, log or wood chip markets, the Minister could make a determination to cancel all or a part of our Forest Act tenures. If this were to occur, we may have to obtain the fibre to run the combined business facilities from external sources, perhaps at a higher cost. A significant increase in our costs could have a material adverse effect on the financial condition and results of operations of the combined business.

Certain Voting Rights of the Non-Voting Shares

The holders of Non-Voting Shares are generally not entitled to vote at meetings of our shareholders. They are, however, entitled to one vote per share on any vote relating to our liquidation, dissolution or winding-up, or the sale, lease or exchange of all or substantially all of our property and as otherwise provided by law or any amendment that would add, change or remove attributes of the Non-Voting Shares or any class of share adversely affecting the Non-Voting Shares either separately or in relation to the Common Shares. As such, holders of Non-Voting Shares will be able to vote on, and potentially affect the outcome of, certain transactions, such as our liquidation or winding-up or the sale of substantially all of our assets.

Evaluation of Disclosure Controls and Procedures

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, Western carried out an evaluation of the design and effectiveness of the Company's disclosure controls and procedures and internal controls over financial reporting as of December 31, 2012. The evaluation was carried out under the supervision and with the participation of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the evaluation, Western's CEO and CFO concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that material information relating to Western and its consolidated subsidiaries is made known to them by others within those entities, particularly during the period in which the annual filings are being prepared. In addition, Western's CEO and CFO concluded that the Company's internal controls over financial reporting are effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for Western and its consolidated subsidiaries for the period in which the annual filings are being prepared.

The CEO and CFO confirm that there were no changes in the controls which materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting during the last quarter of 2012.

Outstanding Share Data

As of February 21, 2013, there were 251,218,424 Common Shares and 216,833,059 Non-Voting Shares issued and outstanding. BSSML controls and directs 48.82% of the Company's Common Shares and 100% of the Non-Voting Shares. The Company may convert the Non-Voting Shares into Common Shares on a one-for-one basis, in whole or in part, at any time in its discretion, provided that an independent committee of the Board of Directors has determined that to do so would not have a material adverse effect on the Company's business, financial condition or business prospects at such time.

Western has reserved 10,000,000 Common Shares for issuance upon the exercise of options granted under the Company's incentive stock option plan. During 2012, 4,700,000 options were granted,

480,000 options were exercised, 990,000 options were forfeited and 155,000 options expired. As of February 21, 2013, 9,516,795 options were outstanding under the Company's incentive stock option plan.

Management's Discussion and Analysis – Appendix A

Summary of Selected Results for the Last Eight Quarters

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

Average Exchange Rate – Cdn \$ to purchase one US \$

Revenue

	2012					2011				
	Year	4 th	3 rd	2 nd (3)	1 st	Year	4 th	3 rd	2 nd	1 st
	1.000	0.991	0.996	1.010	1.001	0.989	1.023	0.980	0.968	0.986
Lumber	624.4	156.1	147.3	163.8	157.2	561.1	147.4	141.2	143.5	129.0
Logs	246.3	62.9	58.5	73.0	51.9	231.6	60.2	77.3	57.8	36.3
By-products	54.7	12.2	13.6	14.6	14.3	61.0	13.1	15.0	17.4	15.5
Total revenue	925.4	231.2	219.4	251.4	223.4	853.7	220.7	233.5	218.7	180.8

Lumber

Shipments – millions of board feet	894	222	218	234	220	811	209	209	210	183
Price – per thousand board feet	698	703	676	700	716	692	705	676	684	705

Logs

Shipments – thousands of cubic metres	3,430	835	876	1,020	699	3,190	853	1,078	755	504
Price – per cubic metre ⁽¹⁾	70	73	65	69	72	69	69	68	72	68

Selling and administration

	29.0	6.9	6.9	7.4	7.8	26.6	6.9	6.4	6.7	6.6
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EBITDA ⁽²⁾

	50.6	14.2	8.4	18.7	9.3	61.6	11.6	15.8	21.2	13.0
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Amortization	(25.8)	(5.9)	(6.2)	(6.9)	(6.8)	(24.0)	(5.7)	(6.0)	(6.7)	(5.6)
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Change in fair value of biological assets	(0.4)	(0.3)	0.4	(0.4)	(0.1)	(2.6)	(0.9)	(0.6)	(0.5)	(0.6)
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Reversal of impairment	12.9	12.9	-	-	-	-	-	-	-	-
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Operating restructuring items	(4.8)	(4.2)	(0.2)	(0.4)	-	(0.7)	0.2	(0.3)	(0.3)	(0.3)
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Finance costs	(5.0)	(1.0)	(1.1)	(1.6)	(1.3)	(6.6)	(1.4)	(1.5)	(1.8)	(1.9)
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Other income (expenses)	2.8	(0.9)	1.1	1.6	1.0	(2.8)	(0.3)	(1.9)	(0.1)	(0.5)
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Income tax recovery (expense)	(0.1)	-	(0.1)	-	-	-	0.1	0.1	(0.2)	-
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Net income from continuing operations	30.2	14.8	2.3	11.0	2.1	24.9	3.6	5.6	11.6	4.1
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Net loss from discontinued operations	(1.1)	(0.2)	(0.3)	(0.4)	(0.2)	(1.1)	(0.3)	(0.3)	(0.2)	(0.3)
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Net income	29.1	14.6	2.0	10.6	1.9	23.8	3.3	5.3	11.4	3.8
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EBITDA as % of revenue	5.5%	6.1%	3.8%	7.4%	4.2%	7.2%	5.3%	6.8%	9.7%	7.2%
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Earnings per share:										
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Net income - basic and diluted	0.06	0.03	-	0.02	-	0.05	0.01	0.01	0.02	0.01
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Net income from continuing operations - basic and diluted	0.06	0.03	-	0.02	-	0.05	0.01	0.01	0.02	0.01
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⁽¹⁾ Note - 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.

⁽²⁾ EBITDA has been restated to reflect the accounting policy change as described on page 16 of the MD&A.

⁽³⁾ Subsequent to filing the interim financial statements for the three and six months ended June 30, 2012, an error was discovered relating to the second quarter net income. Management adjusted net income for the second quarter as it facilitates an understanding of the respective results of the second and third quarter of 2012. The adjustment resulted in an increase to the unrealized loss related to currency forward contracts and recognized in revenues, and a decrease to net income of \$1.7 million from that previously recorded in the three and six months ended June 30, 2012.

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, particularly in the United States, 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.

The category of "Other income (expenses)" comprises net gains on the sale of various assets and other receipts which can be unpredictable in their timing. The fourth quarter 2012 includes the \$12.9 million reversal of an impairment previously taken on the Company's timber licenses (intangible assets) which was an unusual adjustment. The fourth quarter of 2012 included a more significant charge for restructuring as a result of Western incurring a cost of \$4.0 million to reorganize harvesting operations in TFL 44 in order to improve operating performance in the future.

Western Forest Products Inc.

Consolidated Financial Statements
(Expressed in Canadian dollars)

Years ended December 31, 2012 and 2011

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The Management of Western Forest Products Inc. ("Western" or the "Company") is responsible for the accompanying Consolidated Financial Statements and all other information in the Management's Discussion and Analysis. The financial statements have been prepared by Management in accordance with International Financial Reporting Standards and, where necessary, reflect Management's best estimates and judgments at this time. The financial information presented throughout the Management's Discussion and Analysis dated February 21, 2013 is consistent with that contained in the Consolidated Financial Statements.

Western maintains systems of internal accounting controls, policies and procedures to provide reasonable assurances as to the reliability of the financial records and the safeguarding of its assets. Management meets the objectives of internal accounting control on a cost-effective basis through the prudent selection and training of personnel, adoption and communication of appropriate policies, and employment of an internal audit program.

The Board of Directors reviews through oversight Management's responsibilities with respect to the Consolidated Financial Statements primarily through the activities of its Audit Committee, which is composed solely of independent directors of the Company. This Committee meets with Management and the Company's independent auditors KPMG LLP to review the Consolidated Financial Statements and recommend their approval by the Board of Directors. The Audit Committee is also responsible for making recommendations with respect to the appointment, remuneration and the terms of engagement of the Company's auditors. The Audit Committee also meets with the auditors, without the presence of Management, to discuss the results of the audit, related findings and their suggestions.

The Consolidated Financial Statements have been audited by KPMG LLP, who were appointed by the shareholders at the annual shareholders' meeting. The auditors' report follows.



Dominic Gammiero
Chairman



Brian Cairo
Chief Financial Officer

February 21, 2013



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Western Forest Products Inc.

We have audited the accompanying consolidated financial statements of Western Forest Products Inc., which comprise the consolidated statements of financial position as at December 31, 2012, December 31, 2011 and January 1, 2011, the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2012 and December 31, 2011, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Western Forest Products Inc. as at December 31, 2012, December 31, 2011 and January 1, 2011, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2012 and December 31, 2011 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

February 21, 2013
Vancouver, Canada

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. KPMG Canada provides services to KPMG LLP

Western Forest Products Inc.

Consolidated Statements of Financial Position

(Expressed in millions of Canadian dollars)

	December 31, 2012	December 31, 2011 [Restated - Note 3(b)]	January 1, 2011 [Restated - Note 3(b)]
Assets			
Current assets:			
Cash and cash equivalents	\$ 18.8	\$ 15.3	\$ 5.1
Trade and other receivables	69.5	64.4	58.7
Inventory ^{(Notes 3(b) and 4)}	116.6	132.6	119.7
Prepaid expenses and other assets	7.6	6.5	4.8
	<u>212.5</u>	<u>218.8</u>	<u>188.3</u>
Non-current assets:			
Property, plant and equipment ^(Note 5)	194.2	190.3	205.4
Intangible assets ^(Note 5)	126.1	116.6	132.8
Biological assets ^(Note 6)	60.8	59.4	77.7
Assets classified as held for sale ^(Note 24)	-	11.5	-
Other assets ^(Note 7)	12.7	11.7	13.8
	<u>\$ 606.3</u>	<u>\$ 608.3</u>	<u>\$ 618.0</u>
Liabilities and Shareholders' Equity			
Current liabilities:			
Accounts payable and accrued liabilities	\$ 74.0	\$ 66.7	\$ 61.6
Revolving credit facility ^(Note 9)	-	8.9	-
Silviculture provision ^(Note 12)	13.4	13.3	11.5
Discontinued operations ^(Note 22)	5.1	6.2	6.2
	<u>92.5</u>	<u>95.1</u>	<u>79.3</u>
Non-current liabilities:			
Long-term debt ^(Note 9)	33.8	58.5	104.9
Silviculture provision ^(Note 12)	17.6	16.2	15.8
Liabilities classified as held for sale ^(Note 24)	-	1.4	-
Other liabilities ^(Note 11)	35.6	31.6	23.3
Deferred revenue	66.4	68.4	70.4
Discontinued operations ^(Note 22)	2.7	-	-
	<u>248.6</u>	<u>271.2</u>	<u>293.7</u>
Shareholders' equity:			
Share capital - voting shares ^(Note 13)	479.7	412.3	412.3
Share capital - non-voting shares ^(Note 13)	120.3	187.5	187.5
Contributed surplus	4.2	3.4	3.0
Revaluation reserve	22.3	23.9	23.9
Deficit	(268.8)	(290.0)	(302.4)
	<u>357.7</u>	<u>337.1</u>	<u>324.3</u>
	<u>\$ 606.3</u>	<u>\$ 608.3</u>	<u>\$ 618.0</u>

Commitments and contingencies ^(Note 15)

Subsequent event ^(Note 27)

See accompanying notes to these consolidated financial statements

Approved on behalf of the Board



Dominic Gammiero, Chairman



Lee Doney, Vice Chairman

Western Forest Products Inc.

Consolidated Statements of Comprehensive Income

(Expressed in millions of Canadian dollars except for share and per share amounts)

	Year ended December 31,	
	2012	2011 [Restated - Note 3(b)]
Revenue	\$ 925.4	\$ 853.7
Cost and expenses:		
Cost of goods sold ^{(Note 3(b))}	777.8	694.8
Export tax	6.0	6.5
Freight	88.2	90.8
Selling and administration	29.0	26.6
Reversal of impairments ^(Note 5)	(12.9)	-
	888.1	818.7
Operating income prior to restructuring items and other income (expenses)	37.3	35.0
Operating restructuring items ^(Note 19)	(4.8)	(0.7)
Other income (expenses) ^(Note 21)	2.8	(2.8)
Operating income	35.3	31.5
Finance costs ^(Note 20)	(5.0)	(6.6)
Income before income taxes	30.3	24.9
Income tax expense	(0.1)	-
Net income from continuing operations	30.2	24.9
Net loss from discontinued operations ^(Note 22)	(1.1)	(1.1)
Net income	29.1	23.8
Other comprehensive loss		
Change in revaluation reserve	(1.6)	-
Defined benefit plan actuarial losses ^(Note 17)	(7.9)	(11.4)
Total comprehensive income	\$ 19.6	\$ 12.4
Net income per share (in dollars):		
Basic and diluted earnings per share	0.06	0.05
Basic and diluted earnings per share - continuing operations	0.06	0.05
Weighted average number of shares outstanding		
Basic	468,051	467,571
Diluted	476,143	473,738

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.

Consolidated Statements of Changes in Shareholders' Equity

(Expressed in millions of Canadian dollars)

	Share Capital	Contributed Surplus	Revaluation Reserve	Deficit	Total Equity
Balance at January 1, 2011, as previously reported	\$ 599.8	\$ 3.0	\$ 23.9	\$ (292.5)	\$ 334.2
Change in accounting policy ^{(Note 3(b))}	-	-	-	(9.9)	(9.9)
Balance at January 1, 2011, as restated ^{(Note 3(b))}	599.8	3.0	23.9	(302.4)	324.3
Net income for the period	-	-	-	23.8	23.8
Other comprehensive loss:					
Defined benefit plan actuarial losses	-	-	-	(11.4)	(11.4)
Total comprehensive income for the period	-	-	-	12.4	12.4
Share-based payment transactions recognized in equity	-	0.4	-	-	0.4
Total transactions with owners, recorded directly in equity	-	0.4	-	-	0.4
Balance at December 31, 2011, as restated ^{(Note 3(b))}	\$ 599.8	\$ 3.4	\$ 23.9	\$ (290.0)	\$ 337.1
Balance at December 31, 2011, as previously reported	\$ 599.8	\$ 3.4	\$ 23.9	\$ (279.9)	\$ 347.2
Change in accounting policy ^{(Note 3(b))}	-	-	-	(10.1)	(10.1)
Balance at December 31, 2011, as restated ^{(Note 3(b))}	599.8	3.4	23.9	(290.0)	337.1
Net income for the period	-	-	-	29.1	29.1
Other comprehensive loss:					
Change in revaluation reserve	-	-	(1.6)	-	(1.6)
Defined benefit plan actuarial losses	-	-	-	(7.9)	(7.9)
Total comprehensive income for the period	-	-	(1.6)	21.2	19.6
Share-based payment transactions recognized in equity	-	0.9	-	-	0.9
Exercise of stock options	0.2	(0.1)	-	-	0.1
Total transactions with owners, recorded directly in equity	0.2	0.8	-	-	1.0
Balance at December 31, 2012	\$ 600.0	\$ 4.2	\$ 22.3	\$ (268.8)	\$ 357.7

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.

Consolidated Statements of Cash Flows

(Expressed in millions of Canadian dollars)

	Year ended December 31	
	2012	2011 [Restated Note 3(b)]
Cash provided by (used in):		
Operating activities:		
Net income from continuing operations	\$ 30.2	\$ 24.9
Items not involving cash:		
Amortization of property, plant and equipment ^(Note 5)	22.4	20.4
Amortization of intangible assets ^(Note 5)	3.4	3.6
Loss (gain) on disposal of assets	(1.7)	1.3
Change in fair value of biological assets ^(Note 6)	0.4	2.6
Finance costs ^(Note 20)	5.0	6.6
Impairments (reversal of impairments) ^(Note 5)	(12.9)	1.3
Other	(4.8)	(0.3)
	<u>42.0</u>	<u>60.4</u>
Changes in non-cash working capital items:		
Trade and other receivables	(6.6)	(9.0)
Inventory	16.0	(12.9)
Prepaid expenses and other assets	(1.1)	(1.7)
Silviculture provision	0.1	1.8
Accounts payable and accrued liabilities	7.3	5.1
	<u>15.7</u>	<u>(16.7)</u>
	<u>57.7</u>	<u>43.7</u>
Investing activities:		
Additions to property, plant and equipment ^(Note 5)	(32.0)	(19.4)
Proceeds on disposals of assets	16.9	31.3
	<u>(15.1)</u>	<u>11.9</u>
Financing activities:		
Changes in revolving credit facility	(8.9)	8.9
Interest paid	(4.0)	(6.0)
Repayment of long-term debt	(28.0)	(47.1)
Draw down of long-term debt	3.7	-
Refinancing fees	(1.0)	(0.1)
Proceeds from exercise of stock options	0.2	-
	<u>(38.0)</u>	<u>(44.3)</u>
Cash provided by continuing operations	4.6	11.3
Cash used in discontinued operations ^(Note 22)	(1.1)	(1.1)
Increase in cash and cash equivalents	3.5	10.2
Cash and cash equivalents, beginning of period	15.3	5.1
Cash and cash equivalents, end of period	<u>\$ 18.8</u>	<u>\$ 15.3</u>

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

1. Reporting entity

Western Forest Products Inc. ("Western" or the "Company") is a major integrated softwood forest products company, incorporated and domiciled in Canada, operating in the coastal region of British Columbia. The address of the Company's registered office is Suite 510 – 700 West Georgia Street, Vancouver, British Columbia, Canada. The consolidated financial statements as at and for the years ended December 31, 2012 and 2011 comprise the Company and its subsidiaries. The Company's primary business includes timber harvesting, reforestation, forest management, sawmilling logs into lumber, wood chips, and value-added lumber remanufacturing. Western's lumber products are currently sold in over 30 countries worldwide. The Company is listed on the Toronto Stock Exchange, under the symbol WEF.

2. Basis of preparation

(a) Statement of compliance

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), as issued by the International Accounting Standards Board. The consolidated financial statements are available on www.sedar.com. The consolidated financial statements were authorized for issue by the Board of Directors on February 21, 2013.

(b) Basis of measurement

The consolidated 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;
- Land within property, plant and equipment is measured at fair value;
- Liabilities for cash-settled share-based payment transactions are measured at fair value at each reporting period. Equity-settled share-based payments are measured at fair value at grant date;
- Derivative financial instruments are measured at fair value; and
- The defined benefit pension liability is recognized as the net total of the plan assets, plus unrecognized past service costs, less the present value of the defined benefit obligation.

(c) Functional and presentation currency

These consolidated financial statements are presented in the Canadian dollar which is the Company's and its subsidiaries' functional currency. Management believes that the Canadian dollar best reflects the currency of the primary economic environment in which Western operates.

(d) Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRSs requires Management to make judgements, estimates 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 accounting

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the consolidated financial statements are included within the following note:

Note 5 – Property, plant and equipment – determination of appropriate cash generating units

Information about assumption and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

Note 4 – Inventory – measurement of net realizable value

Note 5 – Property, plant and equipment – measurement of the fair value of land

Note 5 – Property, plant and equipment – key assumptions used in discounted cash flows

Note 5 – Intangible assets – key assumptions used in discounted cash flows

Note 12 – Silviculture provision – key assumptions used in discounted cash flows

Note 6 – Biological assets – measurement of fair value less costs to sell of standing timber

Note 13 – Share Capital – measurement of share-based payment transactions

Note 17 – Employee post-retirement benefits – measurement of defined benefit obligations

Note 18 – Financial Instruments – measurement of foreign exchange forward contract derivatives

3. Significant accounting policies

(a) Basis of consolidation

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date on which control ceases.

The principal wholly-owned operating subsidiaries of the Company at December 31, 2012 are Western Lumber Sales Limited (which sells into the United States), Western Forest Products Japan Ltd. (which sells into Japan), and WFP Quatsino Navigation Limited (the beneficial owner of a number of the Company's non-core assets).

Inter-company transactions, balances and unrealized gains on inter-company transactions are eliminated in preparing these consolidated financial statements. Unrealized losses are also eliminated in the same way, unless the transaction provides evidence of an impairment of the asset transferred.

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

(b) Change in accounting policy

On January 1, 2012, the Company changed its accounting policy with respect to the costing of log inventories from the distributed cost method to the average cost of production method. Under the new policy, the costs of logs produced carry an average cost of production based on the operation where the logs are produced, determined by actual log production costs divided by production volumes. This compares to the former policy which allocated costs based on the estimated fair value of the logs produced. Management believes that this change in accounting policy provides more relevant information about the financial performance of the Company to the users of the financial statements, as it aligns the costing methods of the Company's log and lumber inventories, and is more consistent with industry accounting practices and also results in a more conservative carrying value relative to the previous method used.

This change in accounting policy was applied retrospectively with prior periods being restated accordingly. The change resulted in a \$10.1 million reduction to the carrying value of inventory and a corresponding increase to the deficit as at December 31, 2011 (January 1, 2011: \$9.9 million). For the year ended December 31, 2011, the policy change resulted in an increase to cost of goods sold and a decrease to earnings of \$0.2 million from that previously reported.

(c) Adoption of new accounting policies

The following new or amended IFRSs have been issued which are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted, with the exception of IFRS 13 *Fair Value Measurement* which is effective prospectively from January 1, 2013, and IFRS 9 *Financial Instruments* which is effective for annual periods beginning on or after January 1, 2015:

IFRS 9 *Financial Instruments*

IFRS 10 *Consolidated Financial Statements*

IFRS 11 *Joint Arrangements*

IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 13 *Fair Value Measurement*

Amendments to IAS 19 *Employee Benefits*

Amendments to IAS 28 *Investments in Associates and Joint Ventures*

IFRS 9 *Financial Instruments* (2009 and 2010) ("IFRS 9 (2009)" and "IFRS 9 (2010)") will replace IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 (2009) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 (2009) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities.

IFRS 10 *Consolidated Financial Statements* ("IFRS 10") replaces the guidance in IAS 27 *Consolidated and Separate Financial Statements* ("IAS 27") and SIC-12 *Consolidation – Special Purpose Entities*

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

("SIC-12"). IAS 27 (2008) survives as IAS 27 (2011) *Separate Financial Statements*, only to carry forward the existing accounting requirements for separate financial statements. IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are special purpose entities in the scope of SIC-12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 (2008).

IFRS 11 *Joint Arrangements* ("IFRS 11") replaces the guidance in IAS 31 *Interests in Joint Ventures* ("IAS 31"). Under IFRS 11, joint arrangements are classified as either joint operations or joint ventures. IFRS 11 essentially carves out of previous jointly controlled entities those arrangements, which although structured through a separate vehicle, such separation is ineffective and the parties to the arrangement have rights to the assets and obligations for the liabilities and are accounted for as joint operations in a fashion consistent with jointly controlled assets/operations under IAS 31. In addition, under IFRS 11 joint ventures are stripped of the free choice of equity accounting or proportionate consolidation; these entities must now use the equity method. Upon adoption of IFRS 11, entities which had previously accounted for joint ventures using proportionate consolidation shall collapse the proportionately consolidated net asset value (including any allocation of goodwill) into a single investment balance at the beginning of the earliest period presented. The investment's opening balance is tested for impairment in accordance with IAS 28 (2011) and IAS 36 *Impairment of Assets*. Any impairment losses are recognized as an adjustment to opening retained earnings at the beginning of the earliest period presented.

IFRS 12 *Disclosure of Interests in Other Entities* ("IFRS 12") contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e. joint operations or joint ventures), associates and/or unconsolidated structured entities. Interests are widely defined as contractual and non-contractual involvements that expose an entity to variability of returns from the performance of the other entity. The required disclosures aim to provide information in order to enable users to evaluate the nature of, and the risks associated with, an entity's interest in other entities, and the effects of those interests on the entity's financial position, financial performance and cash flows.

IFRS 13 *Fair Value Measurement* ("IFRS 13") replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, i.e. an exit price. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs, the effect of the measurements on profit or loss or other comprehensive income. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRSs. IFRS 13 does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

IAS 19 *Employee Benefits* ("IAS 19") will modify accounting for pensions and other post-retirement and post-employment benefits and impact corporate financial reporting, including reported net profit. The key impacts of the amendments will include:

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

- Changes in how a plan's funded status and its variation during a reporting period will affect the statement of financial position and comprehensive income;
- Changes in the reported benefit expense due to the removal of the expected return on assets and amortization items;
- Significant changes to the footnote disclosures; and,
- Potential implications for the way that plan sponsors manage defined benefit plan risk.

IAS 28 *Investments in Associates and Joint Ventures* ("IAS 28") will modify the existing standard as issued in 2008 as follows:

- Associates and joint ventures held for sale. IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. For any retained portion of the investment that has not been classified as held for sale, the equity method is applied until disposal of the portion held for sale. After disposal, any retained interest is accounted for using the equity method if the retained interest continues to be an associate or a joint venture.
- Changes in interests held in associates and joint ventures. Previously, IAS 28 and IAS 31 specified that the cessation of significant influence or joint control triggered re-measurement of any retained stake in all cases with gain recognition in profit or loss, even if significant influence was succeeded by joint control. IAS 28 will be modified so that in such scenarios the retained interest in the investment is not re-measured.

These new and revised accounting standards have not yet been adopted by Western. The Company does not expect the implementation of these standards to have a material impact on its financial statements.

(d) Operating segments

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. The Company is an integrated Canadian forest products company operating in one business segment comprised of timber harvesting, log sales and lumber manufacturing and sales in world-wide markets.

A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments. Western's log and lumber products are currently sold in over 30 countries worldwide, with sales to customers in Canada, the United States, Asia and Europe representing over 95% of the Company's sales. Substantially all of Western's property, plant and equipment, biological assets and intangible assets are located in British Columbia, Canada.

(e) Foreign currency translation

Foreign currency transactions are translated into Canadian dollars using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into Canadian dollars at the exchange rate on that date. Foreign currency differences arising on translation are recognized in net income for the period. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Canadian dollars at foreign exchange rates at the date the fair value was determined.

(f) Property, plant and equipment

All items of property, plant and equipment are measured at cost, less accumulated depreciation and accumulated impairment losses, except for land, which is measured at fair value at each reporting date.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. The cost of replacing a component of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the component will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced component is derecognized. All other repairs and maintenance are recognized in net income for the period as incurred.

Fair value increases in the carrying amount of land are credited to other comprehensive income and included within the revaluation reserve in shareholders' equity. Fair value decreases that offset previous increases of the same item of land are recognized in other comprehensive income. All other decreases are recognized immediately in net income for the period.

Depreciation is based on the depreciable amount of an item of property, plant and equipment, which is the cost of an item, less its residual value. Depreciation is calculated using the straight-line method and is recognized in net income over the estimated useful life of each component of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives for the current and comparative periods are as follows:

- Buildings and equipment 5 – 20 years
- Logging roads 9 – 20 years

Residual values, depreciation methods and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Gains and losses on disposals are determined by comparing proceeds from disposal with the carrying amount of the item of property, plant and equipment and are recognized in net income for the period in which the disposal occurs.

(g) Biological assets

Standing timber on privately held forest land that is managed for timber production is characterized as a biological asset. Accordingly, at each reporting date, the biological asset is valued at its fair value less costs to sell with any change therein, including the impact of growth and harvest, recognized in net income for the period. Costs to sell include all costs that would be necessary to sell the assets. Standing timber is transferred to inventory at its fair value less costs to sell at the date the logs are

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removed from the forest. Land under the standing timber is measured at fair value at each balance sheet date and included in property, plant and equipment.

(h) Intangible assets

Crown timber tenures are the contractual arrangements between the Company and the Provincial Government whereby the Company gains the right to harvest timber. All of the Company's timber licenses are accounted for as acquired finite lived intangible assets. Accordingly, these are valued at their acquired cost less accumulated amortization and any accumulated impairment losses. Amortization is recognized on a straight-line basis over 40 years, the estimated useful life of these crown timber tenures. Amortization methods, useful lives and residual values are reviewed, and adjusted if appropriate, at each reporting date.

(i) Impairment of non-financial assets

Assets that are subject to amortization are tested for impairment whenever events or changes in circumstance indicate that the carrying amount may not be recoverable. An impairment loss is recognized in net income for the period for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped into cash generating units ("CGU") which are the lowest levels for which there are separately identifiable cash flows.

Impairment losses recognized in prior periods are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the assets' adjusted carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

(j) Inventories

Inventory, other than supplies which are valued at specific cost, are valued at the lower of cost and net realizable value ("NRV") as described below.

(i) Lumber by species (hemlock and balsam, Douglas fir and cedar) and facility;

(ii) Logs by sort by end use (saw logs and pulp logs).

The cost of inventories includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition.

The costs of lumber produced carry an average cost of production based on the species and facility where they were produced. The costs of logs produced carry an average cost of production based on the operation where the logs are produced, determined by actual log production costs divided by production volumes.

NRV is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The NRV for logs designated for lumber production is determined on the basis of the logs being converted to lumber, and for the remaining logs it is based on market log prices.

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The cost of logs transferred from biological assets (standing timber) is its fair value less costs to sell at the date of harvest.

(k) Cash and cash equivalents

Cash and cash equivalents include cash in bank accounts and highly liquid money market instruments with maturities of 90 days or less from the date of acquisition, and are carried at fair value.

(l) Share capital

The Company's authorized capital consists of an unlimited number of common shares ("the Common Shares"), an unlimited number of non-voting shares ("the Non-Voting Shares") and an unlimited number of preferred shares. Common Shares, Non-Voting Shares and preferred shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds, net of any tax effects.

(m) Long-term debt

Long-term debt is recognized initially at fair value, net of transaction costs incurred. Long-term debt is subsequently carried at amortized cost; any difference between the proceeds and the redemption value is recognized in net income for the period over the term of the long-term debt using the effective interest method.

(n) Employee benefits

(i) Employee post-retirement benefits

The Company has various defined benefit and defined contribution plans that provide pension or other retirement benefits to most of its salaried employees and 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. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a retirement plan under which the Company pays fixed contributions into a separate entity.

The Company's net obligation in respect of its defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. Any unrecognized past service costs and the fair value of the plan assets are deducted in arriving at the obligation. The calculation is performed annually by a qualified actuary using the projected benefit actuarial method.

When the calculation results in a benefit to the Company, the recognized asset is limited to the total of any unrecognized past service costs and the present value of economic benefits available in the form of any future refunds from the defined benefit plan or reductions in future contributions to the defined benefit plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to any defined benefit plan.

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Past service costs are recognized immediately in net income for the period, unless the changes to the plans are conditional on the employees remaining in service for a specified period of time ("the vesting period"). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

The Company recognizes all actuarial gains and losses arising from defined benefit plans immediately in other comprehensive income, and reports them in retained earnings. For hourly employees covered by forest industry union defined benefit pension plans, the Company's contributions as required under the collective agreements, are charged to net income for the period.

For Western's defined contribution plan, the Company makes contributions (currently, 7% of employee earnings) to privately administered investment funds on behalf of the plan members. The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense in net income for the period during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

(ii) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits in net income for the period when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. If the benefits are payable more than 12 months after the balance sheet date then they are discounted to their present value.

(iii) Short-term employee benefits

Short-term employee benefit obligations, including bonus plans, are measured on an undiscounted basis and are expensed as the related service is provided.

(iv) Share-based payment transactions

The Company has established share-based payment plans for eligible directors, officers and employees and accounts for these plans using the fair value method. The grant-date fair value of options is recognized as an employee expense, with a corresponding increase in equity, over the period that the individual becomes unconditionally entitled to the awards. The fair value of the options is determined using either the Black-Scholes or the Hull-White option pricing models which take into account, as of the grant date, the exercise price, the expected life of the options, the current price of the underlying stock and its expected volatility, expected dividends on the shares, and the risk-free interest rate over the expected life of the option. In the case of options issued since 2009, the options are only exercisable when the share price exceeds a barrier price of \$0.70 for 60 consecutive days on a volume weighted average price basis. With this additional requirement for the share price to exceed a minimum level before the options become exercisable, it is necessary to utilize the Hull-White model as the Black-Scholes model used for valuing earlier

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granted options is no longer applicable. All options which were previously granted and do not contain the minimum price requirement continue to be valued using the Black-Scholes model. Inherent in all option pricing models is the use of highly subjective estimates, including expected volatility of the underlying shares. The Company bases its estimates of volatility on historical share prices of the Company itself as well as those of comparable companies with longer trading histories. Cash consideration received from employees when they exercise the options is credited to share capital, as is the previously calculated fair value included in contributed surplus.

The grant-date fair value of the amount payable to eligible directors, officers and employees in respect of deferred share units ("DSUs"), which are cash-settled, is recognized as an employee expense with a corresponding increase in liabilities, over the period that the individuals become unconditionally entitled to payment. The liabilities are re-measured at fair value at each reporting date and at settlement date. Any changes in the fair value of the liabilities are recognized in employee expenses in net income for the period.

(o) Silviculture provision

The Company's provision for silviculture relates to the obligation for reforestation on Crown land and arises as timber is harvested. Reforestation on private timberlands is expensed as incurred. The Company recognizes a provision for silviculture at fair value in the period in which the legal obligation is incurred, with the fair value of the liability at the reporting date determined with reference to the present value of estimated future cash flows. The pre-tax discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. The actual discount rate used reflects the current risk-free rate given that risks are incorporated into the future cash flow estimates. In periods subsequent to the initial measurement, changes in the liability resulting from revisions to estimated future cost are recognized in cost of sales within net income for the period as they occur. The unwinding of the discount associated with the provision to reflect the passage of time is included in finance costs within net income for the period.

(p) Revenue recognition

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of rebates and discounts, and after eliminating intercompany sales. Revenue is recognized as soon as the substantial risks and rewards of ownership transfer from the Company to the customer. The timing of the transfers of risks and rewards varies depending on the individual terms of the contract of sale. Lumber and by-product sales are recorded at the time product is shipped and the collection of the amounts is reasonably assured. Consistent with industry practice, log sales are recorded when the customer's order is firm, the logs have been delivered to the transfer location and the collectability of the amount is reasonably assured.

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

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(q) Deferred revenue

Deferred revenue is the result of the contractual obligations incurred upon the acquisition of the Englewood Logging Operation in March 2006, and calls for Western to deliver a specified volume of fibre (chips and pulp logs) over the term of the contract. Accordingly, the deferred revenue is amortized into net income for the period on a straight-line basis over 40 years, being the term of the related fibre supply contract.

(r) Leases

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases and payments made under operating leases are recognized in net income for the period on a straight line basis over the period of the lease.

(s) Finance costs

Finance costs comprise interest expense on long-term debt and the revolving credit facility, unwinding of the discount on the silviculture provision and changes in the fair value of investments recognized immediately through net income. All finance costs are recognized in net income during the period using the effective interest method.

(t) Financial Instruments

(i) Non-derivative financial assets

The Company classifies its financial assets in the following categories: at fair value through profit and loss, loans and receivables, held-to-maturity and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

The Company initially recognizes loans and receivables on the date that they are originated. All other financial assets are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if it eliminates or significantly reduces an accounting mismatch, the Company manages such investments or makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy or the financial asset contains one or more embedded derivatives. Upon initial recognition, attributable transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in net income.

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Financial assets at fair value through profit or loss are comprised of certain investments and forward exchange contracts.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses. Loans and receivables comprise cash and cash equivalents, trade and other receivables. Cash and cash equivalents comprises cash balances and short-term investments with original maturities of 90 days or less.

Held-to-maturity financial assets are debt securities for which the Company has the positive intent and ability to hold to maturity. Held-to-maturity financial assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Held-to-maturity financial assets include certain investments held by the Company.

Available-for-sale financial assets are non-derivative financial assets that are designated as available-for-sale and that are not classified in any of the previous categories. Available-for-sale financial assets are measured at fair value and changes therein, other than impairment losses and foreign currency differences on available-for-sale debt instruments, are recognized in other comprehensive income and presented within equity in the fair value reserve. When an investment is derecognized, the cumulative gain or loss in other comprehensive income is transferred to net income. The Company does not have any financial assets classified as available-for-sale.

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

The Company considers evidence of impairment for receivables and held-to-maturity financial assets at both a specific asset and collective level. All individually significant receivables and held-to-maturity financial assets are assessed for specific impairment. All individually significant receivables and held-to-maturity financial assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables and held-to-maturity financial assets that are not individually significant are collectively assessed for impairment by grouping together receivables and held-to-maturity financial assets with similar risk characteristics.

In assessing for impairment at the collective level, the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for Management's judgement for current economic and credit conditions.

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An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in net income for the period and reflected in an allowance against receivables. Interest on impaired assets continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through net income.

Impairment losses on available-for-sale financial assets are recognized by transferring the cumulative loss that has been recognized in other comprehensive income, and presented in unrealized gains/losses on available-for-sale financial assets in equity, to net income. The cumulative loss that is removed from other comprehensive income and recognized in net income is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in net income. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

(ii) Non-derivative financial liabilities

The Company classifies its financial liabilities as fair value through profit or loss or other financial liabilities.

The Company initially recognizes debt issued on the date that it is originated. The Company derecognizes a financial liability when its contractual obligations are discharged, cancelled, or expire. The Company's non-derivative financial liabilities consist of long-term debt, the revolving credit facility as well as accounts payable and accrued liabilities. These financial liabilities are classified as other financial liabilities and are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method.

(iii) Derivative financial instruments

The Company may enter into derivative financial instruments (foreign currency forward contracts) in order to mitigate its exposure to foreign exchange risk. The Company's policy is not to use derivative financial instruments for trading or speculative purposes. These instruments have not been designated as hedges for accounting purposes, and they are carried on the statement of financial position at fair value with changes in value being recognized as gains or losses within sales in net income for the period.

Embedded derivatives are separated from the host contract and accounted for separately if (a) the economic characteristics and risks of the host contract and the embedded derivative are not closely related, (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and (c) the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in net income.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

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(u) Income tax

Income tax expense comprises current and deferred income tax. Income tax expense is recognized in net income for the period except to the extent that it relates to items recognized either in other comprehensive income or directly in equity, in which case it is recognized in other comprehensive income or equity respectively.

Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred income tax is recognized using the asset and liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting profit nor taxable profit.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled. Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. Such assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(v) Earnings per share

The Company presents basic and diluted earnings per share ("EPS") data for its Common Shares and other Non-Voting Shares. Basic EPS is calculated by dividing the net income attributable to Common and Non-Voting shareholders of the Company by the weighted average number of shares outstanding during the period. Diluted EPS is determined by adjusting the net income attributable to the shareholders and the weighted average number of shares outstanding, for the effects of all dilutive potential shares, which comprise share options granted to employees and directors.

4. Inventory

The following table summarizes the value of inventory on hand:

	December 31, 2012	December 31, 2011 [Restated Note 3(b)]	January 1, 2011 [Restated Note 3(b)]
Logs	\$ 78.9	\$ 88.3	\$ 79.9
Lumber	38.0	46.9	41.9
Supplies and other inventories	10.5	11.3	10.7
Provision for write downs	(10.8)	(13.9)	(12.8)
Total value of inventories	\$ 116.6	\$ 132.6	\$ 119.7
Inventory carried at net realizable value	\$ 34.6	\$ 43.1	34.2

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4. Inventory (continued)

The Company's eligible inventory is pledged as security against the revolving credit facility and long-term debt. During 2012, \$777.8 million (2011: \$694.8 million) of inventory was charged to cost of sales which includes a decrease to the provision for write-down to net realizable value of \$3.1 million.

5. Property, plant and equipment and intangible assets

	Buildings & equipment	Logging roads	Land	Total property, plant and equipment	Intangible assets
Cost					
Balance at January 1, 2011	\$ 117.8	\$ 110.7	\$ 119.0	\$ 347.5	\$ 190.4
Additions	10.7	8.7	-	19.4	-
Disposals	(0.4)	(5.2)	(8.3)	(13.9)	(3.3)
Assets transferred to held for sale	-	(2.7)	-	(2.7)	(16.0)
Balance at December 31, 2011	\$ 128.1	\$ 111.5	\$ 110.7	\$ 350.3	\$ 171.1
Additions	20.9	11.1	0.6	32.6	-
Disposals	(0.8)	(0.2)	(6.1)	(7.1)	-
Balance at December 31, 2012	\$ 148.2	\$ 122.4	\$ 105.2	\$ 375.8	\$ 171.1
Accumulated amortization and impairments					
Balance at January 1, 2011	69.4	72.7	-	142.1	57.6
Amortization	10.8	9.6	-	20.4	3.6
Disposals	(0.1)	(1.6)	-	(1.7)	(1.6)
Impairment	-	-	-	-	1.3
Assets transferred to held for sale	-	(0.8)	-	(0.8)	(6.4)
Balance at December 31, 2011	\$ 80.1	\$ 79.9	\$ -	\$ 160.0	\$ 54.5
Amortization	10.5	11.9	-	22.4	3.4
Disposals	(0.7)	(0.1)	-	(0.8)	-
Reversal of impairments	-	-	-	-	(12.9)
Balance at December 31, 2012	\$ 89.9	\$ 91.7	\$ -	\$ 181.6	\$ 45.0
Carrying amounts					
At January 1, 2011	\$ 48.4	\$ 38.0	\$ 119.0	\$ 205.4	\$ 132.8
At December 31, 2011	\$ 48.0	\$ 31.6	\$ 110.7	\$ 190.3	\$ 116.6
At December 31, 2012	\$ 58.3	\$ 30.7	\$ 105.2	\$ 194.2	\$ 126.1

(a) Intangible assets

Intangible assets are comprised entirely of the Company's Crown timber tenures and are considered to be finite lived intangible assets with an estimated useful life of 40 years.

Due to the global economic situation and the potential impact on lumber demand and prices in the market, Management determined that a review of the recoverable amount of the Company's Crown timber tenures was appropriate at December 31, 2012 and 2011.

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5. Property, plant and equipment and intangible assets (continued)

Management considers that the aggregate of all its crown timber tenures constitute a CGU and so tested the recoverable amount of the CGU, which was based on value in use, with the assistance of an independent valuator.

Value in use was determined by discounting the future cash flows expected to be generated from the continuing use of the CGU. Unless indicated otherwise, value in use in 2012 was determined similarly as in 2011. The calculation of the value in use was determined based on the following key assumptions:

- Cash flows were projected based on historical and forecasted logging activity levels as estimated by Management while working within the constraints of the annual allowable cut levels imposed by the Chief Forester of British Columbia. Management has assumed a 20 year forecast period given the renewability of the licences and the long term nature of the business;
- Log price assumptions used in the projections were based upon consideration of historical actual log prices and long term trend pricing analysis for the Vancouver log market and export log market as published by third party analysts and independent valuers. In the December 31, 2012 estimate of value in use, log prices were expected to remain flat in 2013 and then trend upward to historical averages; in the long-term an average inflation price increase of 1.7% was assumed. Similar assumptions were used in the forecast prepared for December 31, 2011;
- Cash flows for operating costs associated with the crown timber tenures were assumed to be consistent with past experience, actual operating results and are assumed to grow in line with increases in log pricing;
- A pre-tax discount rate of 10.5% (2011: 11.6%) was used in determining the recoverable amount of the CGU. The discount rate used was estimated based on past experience of a weighted average cost of capital for each of the principal timber tenures of the Company, which was based on possible ranges of debt leveraging of between 15% and 35%, dependent upon the risk assessment attached to each particular timber tenure; and,
- A terminal value was determined by assuming a perpetual series of cash flows discounted at the pre-tax discount rate.

As a result of the value in use assessment performed for the CGU as at December 31, 2012, a reversal of \$12.9 million of the impairment loss recorded in previous periods was recognized in profit and loss for the year ended December 31, 2012. The reversal was the result of increases to forecast cash flow margins generated from the Crown timber tenures, due primarily to a reduction in the discount rates in 2012 compared to 2011.

During 2011, an impairment of \$1.3 million was recognized on assets that were sold subsequent to the 2011 year-end, but no further adjustments were made as a result of the impairment review at December 31, 2011.

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5. Property, plant and equipment and intangible assets (continued)

(b) Land

As described in Note 3(f), the Company has elected to measure land at fair value at each reporting date. Management performs an assessment of the fair value for all of its land holdings using a combination of independent third party valuations, recent comparable land sales, and discounted cash flow analysis, as well as considering other publicly available information such as recent market transactions on arm's length terms between willing buyers and sellers, and British Columbia property assessments.

As a result of the fair value assessment of the land holdings at December 31, 2012 and 2011, no fair value adjustments were identified as the carrying value did not differ materially from the estimated fair value.

If land was stated on an historical cost basis, the carrying value would be as follows:

	December 31, 2012	December 31, 2011
Cost	<u>\$ 80.2</u>	<u>\$ 81.6</u>

(c) Other property plant and equipment including sawmills

For the same reasons listed above in (a), Management considered it necessary to conduct an impairment review of its sawmill buildings and equipment at December 31, 2012 and 2011.

Western's sawmills, in aggregate, are considered to be a single CGU for the purposes of assessing the recoverable amount of the CGU. An internal valuation model was utilized to estimate the recoverable amount of the sawmill CGU based on its value in use by determining discounted future cash flows expected to be generated by the sawmills.

The calculation of the fair value was determined based on the following key assumptions:

- Cash flows were projected for 9 years based on past experience, actual operating results and the respective business plans;
- Revenue was projected based on past experience, considerations as to the business plans and a statistical analysis of long-term market price trends for benchmark lumber product sold by species. The anticipated revenue growth during the forecast period was determined based on Management estimates and third party industry sources, and ranges from -3% to 6% per year for each major category of lumber species during the forecast period;
- Log costs were projected based on the assumption that logs would be acquired at market pricing. These were based on past experience, third party industry sources, including historical Vancouver log market pricing, and Management estimates;
- Other costs, including manufacturing, and selling, general and administrative costs were projected to increase at the inflation rate;

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5. Property, plant and equipment and intangible assets (continued)

- A pre-tax discount rate of 16.0% (2011: 16.5%) was applied in the determination of the fair value of the sawmill buildings and equipment. The discount rate was determined based on Management's estimate of the CGU's weighted average cost of capital; and
- A terminal value was determined by applying an earnings multiple to the terminal year earnings before interest, taxes, depreciation and amortization.

As a result of the value in use assessments performed for the sawmill CGU as at December 31, 2012 and 2011, no impairment loss was recognized for the years then ended.

6. Biological assets

	Year ended December 31	
	2012	2011
Carrying value at beginning of year	\$ 59.4	\$ 77.7
Disposition of biological assets	(2.6)	(15.7)
Additions to biological assets	5.6	-
Change in fair value less costs to sell	(1.2)	-
Change in fair value resulting from growth and pricing	1.6	2.3
Harvested timber transferred to inventory during the year	(2.0)	(4.9)
Carrying value at end of year	\$ 60.8	\$ 59.4

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, which the Company has elected to record at fair value at each reporting date (Note 5).

At December 31, 2012, standing timber was located on approximately 23,493 hectares (2011: 23,314 hectares) of land owned by the Company, and range from newly planted cut-blocks to old-growth forests. During the year ended December 31, 2012, the Company harvested and scaled approximately 201,700m³ of logs from its private timberlands, which had a fair value less costs to sell of \$15.9 million at the date of harvest (2011: 365,000m³ - \$25.1 million).

The fair value of the Company's standing timber is based on the following:

- Recent comparative sales of standing timber;
- Direct and indirect costs of sustainable forest management;
- Net present value of future cash flows for standing timber; and,
- Log pricing assumptions as described in Note 5(a).

Accordingly, fair value has been determined using the following significant assumptions:

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6. Biological assets (continued)

- Harvestable volumes have been determined as the estimated future volume and current standing volume to be harvested over the sustainable life of the privately held timberlands. The harvestable volume of standing timber is based on the net planted area, estimated growth rates, estimated yield per hectare and expected sustainable harvest management practices.
- The costs associated with the land owned by the Company on which standing timber are grown including land taxes and other costs.
- The continuation of existing practices with regard to silviculture and harvesting; and
- Discount rates of 5.94% and 6.91% have been applied to the estimated future cash flows in arriving at net present value at December 31, 2012 and December 31, 2011, respectively. These discount rates have been determined with reference to the Company's market determined discount rate for this asset type, based on advice from an independent expert.

The annual valuation of standing timber was carried out during the fourth quarters of 2012 and 2011 using a consistent methodology for establishing fair value less costs to sell.

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.

Dispositions reflected in 2011 primarily relate to the sale of properties to TimberWest Forest Corp. (Note 21).

7. Other assets

	December 31, 2012	December 31, 2011
Investments	\$ 7.9	\$ 7.5
Discontinued operations (equipment)	2.2	2.3
Other	2.6	1.9
	<u>\$ 12.7</u>	<u>\$ 11.7</u>

8. Revolving credit facility

The Company's revolving credit facility provides for a maximum borrowing amount of \$125.0 million, subject to a borrowing base which is primarily based on eligible accounts receivable and inventory balances. The facility bears interest at Canadian prime plus 0.5% (if availability exceeds \$40.0 million) or 0.75% (if availability is less than \$40.0 million) or at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans plus 2.25% or 2.50%, dependent on the same availability criteria. The facility is secured by a first lien interest over accounts receivable and inventory and includes financial covenants (Note 14). The revolving credit facility matures on December 14, 2015 subject to any future refinancing requirements of the Company's revolving and non-revolving term loans. At December 31, 2012, nil was drawn on the facility (2011: \$8.9 million). At December 31, 2012, \$91.1 million of the facility was available to the Company. The interest rate for the revolving credit facility was 3.50% at December 31, 2012 (2011: 3.50%).

Western Forest Products Inc.

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9. Long-term debt

On June 29, 2012, the Company completed the refinancing of its existing revolving term loan facility. Under the terms of the new arrangement, availability under the existing \$75.0 million revolving term loan was increased to \$110.0 million. The revised facility has a maturity date of June 29, 2016. At December 31, 2012, \$75.2 million of the revolving term loan is undrawn and available to the Company.

The loan bears interest at an index rate, determined as the higher of (i) the Canadian Prime rate, and (ii) the 30 day Banker's Acceptance ("BA") rate plus 1.35%, plus the applicable index rate margin which ranges from 1.75% to 3.25%, or at the Company's election, the applicable BA rate, plus the applicable BA rate margin which ranges from 2.75% to 4.25%. The applicable margin is grid-based, determined quarterly, and based on a leverage ratio calculated as the ratio of total debt to EBITDA for the trailing twelve months ending on the date of determination. The loan is secured by a first lien interest over all of the Company's properties and assets except the Englewood Logging Division, over which it has a second lien interest, and excluding all accounts receivable and inventory, and includes financial covenants (Note 14). The interest rate for the revolving term loan was 4.75% at December 31, 2012 (2011: 5.75%).

The Company was in compliance with its financial covenants at December 31, 2012.

	December 30, 2012	December 31, 2011
Canadian dollar debt		
Revolving term loan	\$ 34.8	\$ 59.1
Less transaction costs	(1.0)	(0.6)
	<u>\$ 33.8</u>	<u>\$ 58.5</u>

The transaction costs at December 31, 2012 relate to the new financing arrangements completed in the second quarter. These costs are deferred and being amortized to finance costs over the term of the loan using the effective interest rate method. Deferred transaction costs associated with the previous facility have been fully expensed.

10. Income taxes

	Year ended December 31,	
	2012	2011
Current tax expense		
Current period	\$ 0.1	\$ -
Adjustment for prior periods	-	-
	<u>\$ 0.1</u>	<u>\$ -</u>
Deferred tax expense		
Origination and reversal of temporary differences	\$ 3.5	\$ (11.1)
Change in unrecognized deductible temporary differences	(3.5)	11.1
	<u>-</u>	<u>-</u>
Total income tax expense	<u>\$ 0.1</u>	<u>\$ -</u>

Income tax expense differs from the amount that would be computed by applying the Company's combined Federal and Provincial statutory rate as follows:

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Years ended December 31, 2012 and 2011

10. Income taxes (continued)

	2012	Tax rate	2011	Tax rate
Income before income taxes	\$ 29.2	25.0%	\$ 23.8	26.5%
Income tax using the Company's domestic tax rate	\$ 7.3		\$ 6.4	
Change in future tax rates	0.2		0.1	
Under (over) provided in prior periods	0.3		(0.6)	
Other permanent differences	(4.2)		(3.1)	
Change in unrecognized deductible temporary differences	(3.5)		(2.8)	
	<u>\$ 0.1</u>		<u>\$ -</u>	

The components of deferred income tax are as follows:

	Opening balance	Recognized in profit or loss	Ending balance
For the year ended December 31, 2012			
Deferred tax assets			
Tax loss carry-forwards	\$ 9.1	\$ 0.6	\$ 9.7
Provisions	17.0	1.7	18.7
Property, plant and equipment	7.2	(1.7)	5.5
	<u>33.3</u>	<u>0.6</u>	<u>33.9</u>
Deferred tax liabilities			
Intangible assets	(25.9)	(1.1)	(27.0)
Biological assets	(7.4)	0.5	(6.9)
	<u>(33.3)</u>	<u>(0.6)</u>	<u>(33.9)</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
	Opening balance	Recognized in profit or loss	Ending balance
For the year ended December 31, 2011			
Deferred tax assets			
Tax loss carry-forwards	\$ 11.2	\$ (2.1)	\$ 9.1
Provisions	14.1	2.9	17.0
Property, plant and equipment	10.8	(3.6)	7.2
	<u>36.1</u>	<u>(2.8)</u>	<u>33.3</u>
Deferred tax liabilities			
Intangible assets	(26.4)	0.5	(25.9)
Biological assets	(9.7)	2.3	(7.4)
	<u>(36.1)</u>	<u>2.8</u>	<u>(33.3)</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The Company has unrecognized deferred income tax assets in relation to unused tax losses that are available to carry forward against future taxable income. At December 31, 2012, the Company and its subsidiaries have unused tax losses carried forward estimated at \$393.4 million (2011: \$397.8 million), that expire between 2025 and 2032, available to reduce taxable income and capital losses of \$124.4 million (2011: \$138.1 million) available to be utilized against capital gains.

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10. Income taxes (continued)

Although the Company expects to realize the full benefit of the loss carry-forwards and other deferred income tax assets, due to the economic conditions over the last several years, the Company has not recognized the benefits of its deferred tax assets in excess of its deferred tax liabilities. Deferred tax assets have not been recognized in respect of the following items:

	2012	2011
Tax loss carry-forwards	\$ 479.0	\$ 499.6

11. Other liabilities

	December 31, 2012	December 31, 2011
Employee post-retirement benefits obligation ^(Note 17)	\$ 33.2	\$ 28.8
Environmental accruals	1.5	1.5
Other	0.9	1.3
	<u>\$ 35.6</u>	<u>\$ 31.6</u>

12. Silviculture provision

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

	Year ended December 31,	
	2012	2011
Silviculture provision, beginning of year	\$ 30.9	\$ 27.3
Silviculture provision charged	11.9	13.5
Silviculture work payments	(10.7)	(9.9)
Disposition of intangible assets	(1.4)	(0.4)
Unwind of discount	0.3	0.4
Silviculture provision, end of year	31.0	30.9
Less current portion	13.4	13.3
Less provision transferred to held for sale	-	1.4
Non-current portion	<u>\$ 17.6</u>	<u>\$ 16.2</u>

The silviculture expenditures are expected to occur over the next one to ten years and have been discounted at risk-free rates of 1.10% to 1.80%. The total undiscounted amount of the estimated future expenditures required to settle the silviculture obligation at December 31, 2012 is \$32.2 million (2011: \$32.1million). 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 year.

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13. Share capital

(a) Authorized and issued share capital:

The Company's authorized capital consists of an unlimited number of Common Shares, an unlimited number of Non-Voting Shares and an unlimited number of preferred shares. The Common Shares entitle the holders thereof to one vote per share. The Non-Voting Shares do not entitle the holders to any votes at meetings of the Company's shareholders except that they will be entitled to one vote per share relating to certain matters including liquidation, dissolution and winding-up. The Common Shares and Non-Voting Shares rank equally as to participation in a distribution of the assets of the Company on a liquidation, dissolution or winding-up of the Company and as to the entitlement to dividends.

The holders of the Non-Voting Shares have certain registration rights that enable them to require the Company to assist them with a public offering of the Non-Voting Shares or Common Shares for which the Non-Voting Shares may be exchanged, subject to certain limitations.

Issued and outstanding Common and Non-Voting Shares are as follows:

	Number of Common Shares		Amount	Number of Non-Voting Shares		Amount
Balance at January 1, 2011	128,625,623	\$	412.3	338,945,860	\$	187.5
Balance at December 31, 2011	128,625,623	\$	412.3	338,945,860	\$	187.5
Exercise of stock options	480,000		0.2	-		-
Conversion of Non-Voting Shares to Common Shares	122,112,801		67.2	(122,112,801)		(67.2)
Balance at December 31, 2012	251,218,424	\$	479.7	216,833,059	\$	120.3

On December 4, 2012, the Company and Brookfield Special Situations Management Limited ("BSSML") closed a bought deal secondary offering (the "Offering") through which BSSML sold 62,500,000 Non-Voting Shares of Western at an offering price of \$1.20 per share for aggregate gross proceeds to BSSML of \$75.0 million. On closing of the Offering, the shares were converted, on a one-for-one basis, into Common Shares of Western, representing approximately 33% of the then issued and outstanding Common Shares of Western on a non-diluted basis after giving effect to the Offering.

Immediately following completion of the Offering, 59,612,801 of the then remaining Non-Voting Shares held by BSSML were converted into Common Shares on a one-for-one basis, in accordance with the Company's Articles of Incorporation. As at December 31, 2012, BSSML beneficially held 122,639,345 Common Shares, or 48.82% of the Company's 251,218,424 Common Shares, and 100% of the 216,833,059 Non-Voting Shares issued and outstanding. This represents the same percentages of Common Shares and Non-Voting Shares that BSSML held prior to the Offering.

(b) Stock-based compensation 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 10,000,000 Common Shares. During 2012, the Company recorded compensation expense of \$0.9 million (2011: \$0.4 million) which has been credited to contributed surplus. 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

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Years ended December 31, 2012 and 2011

13. Share capital (continued)

immediately preceding the grant date. Options granted under the Option Plan expire, generally, a maximum of ten years from the date of the grant.

During the year, the Company granted 4,700,000 options with a fair value of \$2.9 million as determined by the Hull-White option pricing model using the assumptions of a weighted average exercise price of \$0.96, risk free interest rates within a range of 1.27% and 2.05%, volatility rates of between 57.0% and 63.5%, and an expected life of between six and ten years. These options are only exercisable when the share price exceeds \$0.70 for 60 consecutive days on a volume weighted average price basis. With the additional requirement for the share price to exceed a certain level before the options become exercisable it was necessary to utilize the Hull-White model. All other options outstanding that were previously granted do not contain the minimum price requirement and continue to be valued under the Black-Scholes model.

During 2012, 480,000 options were exercised, 990,000 options were forfeited and 155,000 options expired. At December 31, 2012, 9,516,795 options were outstanding under the Company's Option Plan with a weighted average exercise price of \$0.86 per Common Share.

The following table summarizes the change in the options outstanding during the years ending December 31, 2012 and 2011:

	2012		2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding, beginning of year	6,441,795	\$0.70	4,741,795	\$0.68
Granted	4,700,000	0.96	1,700,000	0.75
Exercised	(480,000)	(0.31)	-	-
Expired	(155,000)	(1.72)	-	-
Forfeited	(990,000)	(0.49)	-	-
Outstanding, end of year	9,516,795	\$0.86	6,441,795	\$0.70

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13. Share capital (continued)

Details of options outstanding under the share option plan at December 31, 2012 are as follows:

Exercise price	Number outstanding December 31, 2012	Weighted average remaining option life (years)	Weighted average exercise price	Number exercisable December 31, 2012	Weighted average exercise price
\$ 0.22	2,500,000	7.2	\$ 0.22	1,000,000	\$ 0.22
\$ 0.77	1,300,000	8.2	\$ 0.77	260,000	\$ 0.75
\$ 0.95	1,800,000	9.2	\$ 0.95	-	\$ -
\$ 0.96	2,900,000	9.6	\$ 0.96	-	\$ -
\$ 1.20	190,000	5.4	\$ 1.20	160,800	\$ 1.20
\$ 1.75	436,000	3.5	\$ 1.75	436,000	\$ 1.75
\$ 2.20	366,000	4.7	\$ 2.20	366,000	\$ 2.20
\$ 12.10	24,795	1.6	\$ 12.10	24,795	\$ 12.10
	<u>9,516,795</u>	<u>8.1</u>	<u>\$ 0.86</u>	<u>2,247,595</u>	<u>\$ 1.10</u>

The Company also has a Deferred Share Unit ("DSU") Plan for directors and designated executive officers. Directors may elect to take a portion of their fees in the form of DSUs and executives may 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 their quarterly fee's the director elected to take in DSUs by the share price value on the fifth day following each quarter end. For executive officers, the number of DSUs allotted is determined by dividing the dollar portion of the bonus that the executive elected to take in DSUs by the weighted average price of the Company's Common Shares for the five business days prior to the issue notification date. During 2012, designated executive officers were allotted 116,163 DSUs at a price of \$0.99 per DSU and a further 40,797 DSUs were issued to a director at a weighted average price of \$1.02 per DSU. The cumulative number of DSUs outstanding at December 31, 2012 was 980,191 (2011: 823,231). In 2012, the Company recorded compensation expense for these DSUs of \$0.6 million (2011: \$0.2 million), with a corresponding increase to accounts payable and accrued liabilities.

(c) Income per share:

Basic income per share was calculated by dividing the net income by the weighted average number of Common Shares and Non-Voting Shares issued and outstanding over the period. Diluted net income per share was calculated by reference to the fully diluted weighted average number of shares outstanding as determined using the treasury stock method and considering the dilutive effect, if any, of employee stock options (Note 13(b)).

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14. Capital requirements

The Company's strategy for managing capital is to maintain a capital position that provides financial flexibility and achieves growth with the objective of maximizing long-term shareholder value. Western's capital requirements typically include major new investments designed to increase net income and disbursements for other new equipment and ongoing enhancements, efficiency improvements, safety, and protection or extension of the life of equipment. Finally, significant expenditures are also required to fund new capital roads allowing access to timber stands for harvesting purposes. During 2012, capital expenditures continued to be monitored closely because of the uncertain economic climate, but spending on certain strategic capital projects has commenced because of Western's stronger financial position and growing confidence in the lumber markets.

The Company seeks to achieve a balance between the higher returns that may arise with higher levels of borrowing and the advantages and security provided by a sound capital position. The Company monitors the ratio of net debt to capitalization. Given the current uncertain market conditions the Company has reduced its debt position and has a net capitalization to debt ratio of 4%. Net debt is defined as long-term debt plus amounts drawn on the revolving credit facility, less cash and cash equivalents. Capitalization comprises net debt and shareholders' equity.

Changes to the capital structure may be made as strategic opportunities arise. In order to maintain or adjust the capital structure, the Company may issue new shares, source new debt, or sell assets to reduce debt. The Company has internal controls to ensure changes to the capital structure are properly reviewed and approved.

Since originally refinancing its term debt in March of 2008, the Company has repaid a total of \$140.2 million of the term loans, substantially from the cash proceeds of disposition of non-core assets. Pursuant to the re-financing agreement completed on June 29, 2012 (Note 9), term debt repayments will continue as non-core asset sales are realized.

Under the current financing agreements, the Company is subject to financial covenants. The revolving credit facility contains two financial covenants: (i) minimum consolidated adjusted shareholders' equity of \$200.0 million: and (ii) should availability fall below \$10.0 million or in the event of default, minimum fixed charge coverage ratio of 1.1:1.0. The revolving term loan facility contains two financial covenants: (i) maximum loan to value ratio of 55% on or before December 31, 2013 and following this a loan to value ratio of 50% (loans are defined as the total term loans outstanding and value is defined as the appraised value of our crown tenures and private timberlands. This financial covenant is measured on the last day of each fiscal year and at the time of consummation of a sale or disposition of assets, with certain exceptions) and (ii) maximum funded debt to capitalization of 0.45 to 1.0, measured on a quarterly basis. As at December 31, 2012, the Company is in compliance with all financial covenants, and expects to be in compliance for the next 12 months.

The Company is not subject to any statutory capital requirements. Under the Company's stock-based compensation plan, commitments exist to issue common shares.

There were no changes to the Company's approach to managing capital during the year.

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15. Commitments and contingencies

(a) *Lumber duties and export tax*

Under the softwood lumber agreement ("SLA") between Canada and the United States, the Company's exports to the United States are assessed an export tax by the Canadian Government. The SLA, which became effective October 12, 2006, has a term of seven years with provision for an extension of two years and for early termination by either Government after two years. On January 23, 2012 the agreement was extended by two years and now terminates in October, 2015. The export tax rate varies according to the price of lumber based on the "Random Lengths Framing Lumber Composite Index" ("Index") and ranges from zero percent when the Index is above US\$355 per thousand board feet to 15% when the Index is under US\$315 per thousand board feet.

The export tax only applies to the first US\$500 per thousand board feet for any product sales. In addition, if the monthly volume of exports from the British Columbia coastal region exceeds a certain "Trigger Volume" as defined in the SLA, a "surge" mechanism will apply to increase the rate of the export tax for that month by 50% (for example, the 15% export tax rate would become 22.5% for that month). During 2012, the Company recorded an expense of \$6.0 million (2011: \$6.5 million) which reflects the fact that even though shipment volumes to the US were higher in 2012 compared to 2011, export taxes were lower as prices were on average higher in 2012 leading to a lower export tax rate being applicable for certain periods.

(b) *Litigation 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. The Company has claims filed against it from logging contractors and unions with respect to various operating issues. Certain of the claims are pending mediation or arbitration, while others have not yet reached this formal stage. Where the Company is not able to determine the outcome of these disputes no amounts have been accrued in these financial statements.

(c) *Long-term fibre supply agreements*

The Company has a number of long-term commitments to supply fibre to third parties including a 40 year agreement, entered into on March 17, 2006 ("40 Year Agreement"). As consideration for entering into the 40 Year Agreement the Company received a price premium of \$80.0 million that will be earned as wood chips are delivered under the agreement. Upon execution, a non-refundable prepayment of the price premium of \$35.0 million was received with the balance of \$45.0 million set-off against the consideration due by the Company on its acquisition of the Englewood Logging Division from the same party to the fibre supply agreement. The Company recorded the price premium as deferred revenue (Note 3(q)) and has granted a first charge over the acquired assets (including a tree farm license with an allowable annual cut of 844,000 cubic metres, 4,771 hectares of private timberlands and other capital improvements and equipment) to secure certain of these obligations.

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15. Commitments and contingencies (continued)

In addition, 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 volume, require the Company to conduct whole log chipping, 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.

The Company has satisfied its annual fibre commitments for 2012.

(d) Operating leases

Future minimum lease payments at December 31, 2012 under operating leases were as follows:

2013	\$	3.1
2014		2.9
2015		2.3
2016		1.9
2017		1.3
Thereafter		5.3
	\$	<u>16.8</u>

(e) Allowable annual cut reductions

During 2012, adjustments were made to the Annual Allowable Cuts ("AAC") of three tree farm licences ("TFL"s). On February 10, 2012 the total AAC of TFL 6 was reduced from 1,255,535m³ to 1,160,000m³ as a result of a periodic determination by the provincial Chief Forester. Of this total volume, 1,148,422m³ is held by Western and 11,578 m³ by the Crown. On March 15, 2012, the AAC attributable to Western for TFL 19 was reduced by 1,163 m³ to reflect the removal of three small parcels of Crown land as a result of a private land exchange. On May 28, 2012 a portion of TFL 39 Block 1 was deleted by the Crown in order to provide a forest tenure opportunity to a local First Nation. This deletion reduced the total TFL AAC by 22,000m³ but did not affect Western's AAC rights within the tenure, as this AAC was already held by the Crown. Also in 2012, the Company sold TFL 60 to Taan Forest Limited Partnership ("Taan"). The AAC for the tenure at the time of transfer was 802,868m³.

(f) Pension funding commitments

The Company is committed to making estimated annual special payments in relation to its salaried pension plans of \$2.3 million a year for 2013 to 2015 and \$0.8 million per year for 2016 to 2025, or until such time as a new funding valuation may lead to a change in the amount of payments required.

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16. Segmented information

The Company manages its business as a single operating segment. The Company purchases and harvests logs which are then manufactured into lumber products at the Company's sawmills, or sold. Substantially all of the Company's operations are located in British Columbia, Canada.

The Company's sales, based on the known origin of the customer, were as follows:

	2012	2011
Canada	\$ 402.9	\$ 369.1
Japan	207.3	182.3
China	130.3	126.0
United States	116.4	92.1
Europe	35.6	38.1
Other	32.9	46.1
	<u>\$ 925.4</u>	<u>\$ 853.7</u>

Substantially all of the Company's property, plant and equipment is located in British Columbia, Canada.

17. Employee future benefits

The Company has several funded and unfunded defined benefit plans, a defined contribution pension plan and a group RRSP that provide retirement benefits to substantially all salaried employees and certain hourly employees. In addition, the Company provides other unfunded post-employment benefits to certain former salaried and hourly employees. The funded and unfunded defined benefit pension plans were closed to new entrants effective June 30, 2006, and effective December 31, 2010, no further benefits accrue under these plans as members became eligible to participate in the defined contribution plan. All new salaried employees are now provided with pension benefits through a defined contribution plan. The defined benefit plans are based on years of service to December 31, 2010, and final average earnings. The Company's other post-employment benefit plans are non-contributory and include a range of health care and other benefits. Total cash payments for employee future benefits for the year ended December 31, 2012 were \$14.2 million (2011: \$13.6 million), consisting of cash contributed by the Company to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to the forest industry union defined benefit plans. In relation to defined benefit plans, the Company measures the fair value of plan assets and the accrued benefit obligations for accounting purposes as at December 31 of each year. The most recent actuarial valuations of the funded defined benefit pension plans were at December 31, 2010. The next actuarial valuation for both the funded and unfunded defined benefit plans and other unfunded post-employment benefit plans will be prepared for December 31, 2013.

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17. Employee future benefits (continued)

Information about the Company's defined benefit salaried pension plans and other non-pension benefits, in aggregate, is as follows:

	Year ended December 31, 2012		Year ended December 31, 2011	
	Salaried pension plans	Non-pension plans	Salaried pension plans	Non-pension plans
Plan assets:				
Fair value, beginning of year	\$ 97.0	\$ -	\$ 102.1	\$ -
Company contributions	3.7	0.4	3.5	0.4
Benefits and administrative expenses paid	(8.2)	(0.4)	(8.1)	(0.4)
Actual return on assets	9.1	-	(0.5)	-
Fair value, end of year	<u>\$ 101.6</u>	<u>\$ -</u>	<u>\$ 97.0</u>	<u>\$ -</u>
Accrued benefit obligation:				
Balance, beginning of year	\$ 118.2	\$ 7.6	\$ 115.8	\$ 7.3
Current service cost and administrative expenses	0.3	-	0.3	-
Benefits and administrative expenses paid	(8.2)	(0.4)	(8.1)	(0.4)
Interest cost	5.6	0.4	6.0	0.4
Actuarial loss	10.8	0.5	4.2	0.3
Balance, end of year	<u>\$ 126.7</u>	<u>\$ 8.1</u>	<u>\$ 118.2</u>	<u>\$ 7.6</u>
Deficit recognized in Statement of Financial Position (Note 11)	<u>\$ (25.1)</u>	<u>\$ (8.1)</u>	<u>\$ (21.2)</u>	<u>\$ (7.6)</u>
Actuarial losses recognized directly in OCI	\$ (7.3)	\$ (0.6)	\$ (11.1)	\$ (0.3)
Cumulative amounts of actuarial losses recognized at start of year	(18.7)	(0.8)	(7.6)	(0.5)
Cumulative amounts of actuarial losses recognized at end of year	<u>\$ (26.0)</u>	<u>\$ (1.4)</u>	<u>\$ (18.7)</u>	<u>\$ (0.8)</u>
Experience gains (losses):				
Difference between actual and expected return on plan assets:				
- amount	\$ 3.5	n/a	\$ (6.9)	n/a
- % of plan assets	3.4%	n/a	(7.1)%	n/a
Experience gains (losses) on plan liabilities:				
- amount	\$ (0.3)	\$ -	\$ 5.3	\$ 0.1
- % of plan liabilities	(0.2)%	-%	4.5%	0.8%

Included in the above accrued benefit obligations and plan assets for salaried pension plans are accrued benefit obligations of \$118.9 million at December 31, 2012 (2011: \$110.7 million) in respect of plans that are wholly or partly funded.

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except per share amounts)

Years ended December 31, 2012 and 2011

17. Employee future benefits (continued)

The following is a breakdown of the pension plan assets into their major investment categories:

	December 31, 2012	December 31, 2011
Equity securities	46%	59%
Debt securities	52%	40%
Other	2%	1%
	<u>100%</u>	<u>100%</u>

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows:

	December 31, 2012	December 31, 2011
Discount rate at beginning of year for:		
Non-pension plans	4.90%	5.30%
Pension plans	4.97%	5.36%
Discount rate at end of year for:		
Non-pension plans	4.10%	4.90%
Pension plans	4.19%	4.97%
Expected long-term return on assets of pension plans	6.00%	6.40%
Rate of compensation increase for all plans	3.38%	3.38%
Health care cost trend rate	5.9% in 2013 grading to 4.3% in 2023	6.7% for 2012 grading to 4.5% in 2023

A reduction of 1% in the assumed health care cost trend rate assumption has the effect of reducing the accrued benefit obligation by \$0.7 million and an increase in the rate by 1% increases it by \$0.9 million. The expected rate of return on plan assets is determined by taking into account the expected return on the assets based on the Company's current investment policy.

The Company's salaried pension and non-pension benefits expense is as follows:

	Year ended December 31, 2012		Year ended December 31, 2011	
	Salaried pension plans	Non-pension plans	Salaried pension plans	Non-pension plans
Defined benefit plans:				
Current service cost and expected administrative expenses	\$ 0.3	\$ -	\$ 0.3	\$ -
Interest cost	5.6	0.4	6.0	0.4
Expected return on plan assets	(5.7)	-	(6.3)	-
Total for defined benefit plans	0.2	0.4	-	0.4
Defined contribution plans	2.5	-	2.3	-
Net periodic pension expense	\$ 2.7	\$ 0.4	\$ 2.3	\$ 0.4

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17. Employee future benefits (continued):

The Company expects to make funding contributions to its defined benefit plans of \$2.3 million during 2013.

The Company's unionized employees are members of industry-wide pension plans to which the Company contributes a predetermined amount per hour worked by an employee. As there is insufficient information available for the Company to account for these plans as defined benefit plans, the plans have been accounted for as defined contribution plans. The Company's liability is limited to its contributions. The pension expense for these plans is equal to the Company's contributions and for 2012 amounted to \$7.6 million (2011: \$7.3 million).

18. Financial instruments

(a) Accounting classifications and fair values

(i) Fair value hierarchy

The table below provides financial instruments carried at fair value, by valuation hierarchy. The levels of the fair value hierarchy are defined as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly; and

Level 3 – Inputs for the asset or liability that are not based on observable market data.

	Total	Level 1	Level 2	Level 3
December 31, 2012				
Assets:				
Investments	\$ 4.8	\$ 4.8	\$ -	\$ -
Liabilities:				
Foreign currency forward contracts	\$ 0.1	\$ -	\$ 0.1	\$ -
December 31, 2011				
Assets:				
Investments	\$ 4.8	\$ 4.8	\$ -	\$ -
Liabilities:				
Foreign currency forward contracts	\$ 2.8	\$ -	\$ 2.8	\$ -

Western Forest Products Inc.

Notes to the Consolidated Financial Statements

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Years ended December 31, 2012 and 2011

18. Financial instruments (continued)

(ii) Fair value versus carrying value

The carrying value of trade and other receivables and accounts payable and accrued liabilities included in the consolidated statements of financial position approximate their fair value due to the short term to maturity of these instruments.

The carrying value of the long-term debt included in the consolidated statements of financial position approximates its fair value as the debt bears floating interest rates that approximate market rates. Furthermore, the Company has not experienced a significant change in its credit risk since initial recognition of the debt.

(b) *Financial risk management*

The use of financial instruments exposes the Company to credit risk, liquidity risk, and market risk. Other than as described below, Management does not consider the risks to be significant to the Company.

The Board of Directors has oversight responsibility for the Company's risk management framework. The Company identifies, analyzes and actively manages the financial market risks associated with changes in foreign exchange rates, interest rates and commodity prices. Western has established risk management policies and controls to identify and analyze the risks faced by the Company, to set appropriate risk limits and to monitor risks and adherence to limits. Currently, the Company is only engaged in foreign exchange forward contract activities.

(i) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's receivable from customers, and cash and cash equivalents. The carrying amount of the Company's trade and other receivables and cash and cash equivalents represents the maximum credit exposure.

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. However, Management also considers the demographics of the Company's customer base, including the default risk of the industry and country in which customers operate, as these factors may have an influence on credit risk. The Company has determined that there is no concentration of credit risk either geographically or by counterparty.

Sales transactions are made through the extension of credit to customers and are recorded at the point in time the sale is recognized. Accordingly, fluctuations in collectability may affect the carrying value of the underlying accounts receivable. Management balances the credit risk through rigorously and continually reviewing customer credit profiles. The Company has established policies and controls to review the creditworthiness of new customers, including review of credit ratings. Most lumber sales are conducted under standard industry terms and conditions and most export sales are insured up to 90% of sales values by the Export Development Corporation.

The Company regularly reviews the collectability of accounts receivable and makes provisions where the collectability is uncertain. Historically the Company's bad debts have been minimal and as at December 31, 2012, the Company had an allowance for doubtful customer accounts of \$0.4 million

Western Forest Products Inc.

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Years ended December 31, 2012 and 2011

18. Financial instruments (continued)

(2011: \$0.1 million). The aging of trade and other receivables at the reporting date that were not impaired was as follows:

<i>(in millions of dollars)</i>	December 31, 2012		December 31, 2011	
	Gross value	Impairment	Gross value	Impairment
Not past due	\$ 65.4	\$ -	\$ 50.7	\$ -
Past due 0-30 days	2.9	-	10.1	-
Past due 31-120 days	1.6	0.4	3.6	-
More than 1 year	-	-	0.1	0.1
	<u>\$ 69.9</u>	<u>\$ 0.4</u>	<u>\$ 64.5</u>	<u>\$ 0.1</u>

The Company held cash and cash equivalents of \$18.8 million at December 31, 2012 (2011: \$15.3 million), which represents its maximum credit exposure on these assets. The cash and cash equivalents are held at highly rated financial institutions and as such, the Company does not believe that these are exposed to significant credit risk.

(ii) Interest rate risk

The Company is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Based on the Company's debt structure at December 31, 2012, a change of 1% in interest rates would have increased or decreased annual net income by approximately \$0.3 million. The Company does not currently use derivative instruments to reduce its exposure to interest rate risk.

(iii) Currency risk

Certain of the Company's sales transactions are denominated in foreign currencies, principally, the US dollar and Japanese Yen ("JPY"), and accordingly the Company is exposed to currency risk associated with changes in foreign exchange rates. To assist in mitigating this exchange risk, the Company has entered into an agreement dated March 31, 2009 with Brookfield Asset Management ("BAM") to provide a foreign exchange facility ("Facility") to the Company. The Facility, which is for a notional amount of up to US\$80.0 million, matures on March 31, 2013, and allows for forward transactions with a maximum term for each transaction of up to one year. The maturity date is subject to automatic annual renewal subject to BAM notifying the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and to certain change of control provisions being invoked. The Facility is unsecured and is subject to a fee of 0.10% of the notional amount per annum. The Company does not consider the credit risk associated with this Facility to be significant.

During 2012, the Company entered into contracts under the facility to sell US dollars and JPY forward in order to mitigate a portion of this foreign currency risk. At December 31, 2012, the Company had outstanding obligations to sell US\$42.0 million at an average exchange rate of CAD\$0.9935 per US dollar with maturities through May 31, 2013, and to sell an aggregate JPY 400 million at a rate of JPY 86.79 per CAD dollar with a maturity date of January 15, 2013.

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18. Financial instruments (continued)

All foreign currency gains and losses to December 31, 2012 have been recognized in sales in the consolidated statement of comprehensive income and the fair value of these instruments at December 31, 2012 was a net liability of \$0.1 million which is included in accounts payable and accrued liabilities on the consolidated statement of financial position (2011: \$2.8 million). A net gain of \$2.7 million (2011: \$0.8 million) was recognized in sales in the consolidated statement of comprehensive income on the change in fair values of the foreign exchange contracts. An increase (decrease) of 1% in the value of the Canadian dollar as compared to the JPY would have an immaterial impact on JPY foreign exchange forward contracts held at year end. An increase (decrease) of 1% in the value of the Canadian dollar as compared to the US dollar would result in a gain (loss) of approximately \$0.4 million in relation to the US dollar foreign exchange contracts held at December 31, 2012.

Certain receivable balances at December 31, 2012 are denominated in foreign currencies, principally, the US dollar. Accordingly, fluctuations in foreign exchange rates may affect the carrying value of the underlying accounts receivable. As of December 31, 2012, the Company's accounts receivable denominated in US dollars totaled \$29.3 million. An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in a decrease (increase) in US dollar denominated accounts receivable at year end of approximately \$0.3 million. In addition, as at December 31, 2012, the Company had a total of \$3.7 million in US dollar denominated cash and cash equivalents. An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in an immaterial change to US dollar denominated cash and cash equivalents at year end.

(iv) Commodity price risk

The Company does not enter into commodity contracts other than to meet the Company's expected usage and sale requirements and such contracts are not settled net.

(v) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. Management mitigates any liquidity risk associated with the subsequent payment of liabilities through the continual monitoring of expenditures and forecasting of liquidity resources. The Company maintains a revolving credit facility that can be drawn down to meet short-term financing and liquidity needs.

As at December 31, 2012, the Company had \$166.3 million (2011: \$96.8 million) available under its credit facility and revolving term loan. The following are the contractual maturities of financial liabilities, including estimated interest payments:

	Carrying amount	Contractual cash flows	6 months or less	6-12 months	2-3 years	4-5 years	More than 5 years
Accounts payable and accrued liabilities	\$ 74.0	\$ 74.0	\$ 74.0	\$ -	\$ -	\$ -	\$ -
Revolving term loan	33.8	41.8	1.0	1.0	4.0	35.8	-
Revolving credit facility	-	3.6	0.6	0.6	2.4	-	-
	<u>\$ 107.8</u>	<u>\$ 119.4</u>	<u>\$ 75.6</u>	<u>\$ 1.6</u>	<u>\$ 6.4</u>	<u>\$ 35.8</u>	<u>\$ -</u>

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19. Operating restructuring items

Operating restructuring items for 2012 of \$4.8 million (2011: \$0.7 million) primarily relate to \$4.0 million expensed as a result of reorganizing harvesting operations in TFL 44 in order to improve operating performance in the future. The balance of \$0.8 million relates to severance costs incurred with respect to departmental reorganizations. The restructuring charges in 2011 of \$0.7 million related to severance costs associated with restructuring of administrative functions.

20. Finance costs

	Year ended December 31	
	2012	2011
Revolving credit facility	\$ 0.8	\$ 1.3
Long-term debt	3.0	4.2
Amortization of deferred financing costs	1.0	0.9
Accretion	0.3	0.4
Other	(0.1)	(0.2)
	<u>\$ 5.0</u>	<u>\$ 6.6</u>

21. Other income (expenses)

The most significant items comprising other income of \$2.8 million in 2012 were: net gains on non-core asset disposals in the year of \$1.1 million; proceeds of \$1.1 million received as final compensation from the Province of British Columbia resulting from the creation of new protective areas in our Haida Gwaii and Central Coast operating areas; \$0.9 million received as reimbursement for engineering and other infrastructure costs associated with an area that was deleted from TFL 39 in order to provide the Sliammon First Nation with a treaty related forest tenure opportunity; and \$0.3 million related to other miscellaneous expenses.

Other expenses of \$2.8 million in 2011 comprised: a gain on the sale of an equity interest in certain real estate properties of \$2.4 million; an expense incurred of \$2.5 million to secure amendments to the terms of certain contractual arrangements; and losses on non-core asset disposals of \$2.7 million. The most significant non-core asset sale in the year was the sale to TimberWest Forest Corp. of 7,678 hectares of land located in the southern portion of Vancouver Island near Jordan River for gross proceeds of \$21.9 million.

22. Discontinued operations

In March 2006, the Company closed its Squamish mill located on 212 acres on the mainland coast of British Columbia and exited the pulp business. Subsequent to the closure, the Company sold substantially all of the manufacturing assets of the mill. Ongoing costs including supervision, security and property taxes continue to be expensed as incurred. The real property is one of the Company's portfolio of non-core assets (Note 27).

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22. Discontinued operations (continued)

The following table provides additional information with respect to the discontinued operations:

	For the year ending December 31	
	2012	2011
Net loss from discontinued operations	\$ (1.1)	\$ (1.1)
Cash used in discontinued operations	\$ (1.1)	\$ (1.1)
	December 31, 2012	December 31, 2011
Assets of discontinued operations	\$ 2.2	\$ 2.3
Liabilities of discontinued operations	\$ 7.8	\$ 6.2

23. Related parties

(a) Related party transactions

BSSML controls and directs 48.82% of the Company's Common Shares and 100% of the Non-Voting Shares. BSSML is a wholly owned subsidiary of BAM.

In addition to the related party transactions identified elsewhere in these consolidated financial statements, the Company has certain arrangements with entities related to BSSML and BAM to provide financing, acquire and sell logs, lease certain facilities, provide access to roads and other areas, and acquire services including insurance, all in the normal course and at market rates or at cost. The following table summarizes these transactions:

Western incurred costs with related parties as follows:

	Year ended December 31	
	2012	2011
Log purchases	\$ 11.5	\$ 13.5
Other	6.5	4.7
	<u>\$ 18.0</u>	<u>\$ 18.2</u>

Western received the following revenues from related parties:

	Year ended December 31	
	2012	2011
Log sales	\$ 7.9	\$ 5.4
Other	-	2.4
	<u>\$ 7.9</u>	<u>\$ 7.8</u>

At December 31, 2012, \$0.1 million of the costs incurred with related parties for the year then ended were included in accounts payable and accrued liabilities (2011: \$1.7 million).

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23. Related parties (continued)

(b) Compensation of key management personnel

The key management personnel of the Company include the executive management team and members of the Board of Directors. Key management personnel compensation comprised:

	Year ended December 31	
	2012	2011
Salaries and directors' fees	\$ 2.7	\$ 2.2
Post-employment benefits	0.2	0.2
Share-based payments	0.9	0.7
	<u>\$ 3.8</u>	<u>\$ 3.1</u>

At December 31, 2012, \$0.5 million of the key management compensation costs incurred for the year then ended were included in accounts payable and accrued liabilities (2011: \$0.5 million)

24. Non-current assets held for sale

The assets and liabilities related to Tree Farm License 60 ("TFL 60") were presented as a disposal group held for sale at December 31, 2011 following the Company reaching an agreement on October 11, 2011 to sell TFL 60 to Taan. Taan is a partnership of the Council of the Haida Nation and Haida Enterprise Corporation, the business arm of the Haida Nation. An impairment loss of \$1.7 million on the re-measurement of the disposal group to the lower of its carrying amount and its fair value less costs to sell was recognized in other income (expenses) in the consolidated statement of comprehensive income in 2011. The major classes of assets and liabilities classified as held for sale as at December 31, 2011 comprise property plant and equipment (\$1.9 million), intangible assets (\$9.6 million), and silviculture liabilities (\$1.4 million).

The Company completed the sale of TFL 60 to Taan during the second quarter of 2012. Under the terms of the sale, Western received net proceeds of approximately \$12.2 million in 2012, and certain ongoing rights to cedar logs harvested by Taan. Taan assumed substantially all of the obligations of Western on Haida Gwaii.

25. Expense categorization

Expenses by function:

	Year ended December 31	
	2012	2011
Administration	\$ 19.5	\$ 16.8
Distribution expenses	103.7	107.1
Cost of goods sold	777.8	694.8
	<u>\$ 901.0</u>	<u>\$ 818.7</u>

Western Forest Products Inc.

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25. Expense categorization (continued)

The following information is required to facilitate a complete "costs by nature" presentation:

	Year ended December 31	
	2012	2011
Compensation costs	\$ 190.9	\$ 182.2
Amortization in cost of goods sold	24.6	22.7
Amortization in selling and administration	1.2	1.3
	<u>\$ 216.7</u>	<u>\$ 206.2</u>

26. Seasonality of Operating Results

Quarterly trends normally reflect the seasonality of the Company's operations. Logging operations are seasonal due to a number of factors including weather, ground conditions and fire season woods closures. Generally, the Company's B.C. Coastal logging divisions experience higher production levels in the latter half of the first quarter, throughout the second quarter, dependent on fire hazard in the third quarter, and in the first half of the fourth quarter. Sawmill operations are less seasonal than logging operations but are dependent on the availability of logs from logging operations, including those from suppliers. In addition, the market demand for lumber and related products is generally lower in the winter due to reduced construction activity, which increases during the spring, summer and fall.

27. Subsequent event

On January 28, 2013, Western announced that it has entered into a conditional agreement for the sale of its former Woodfibre Pulp Mill site for the gross purchase price of \$25.5 million. The site, consisting of 212 acres of industrial waterfront land, is located at the head of Howe Sound, southwest of Squamish, British Columbia.

Closing is subject to certain conditions, and Western will be responsible for satisfactorily remediating the property to applicable environmental standards prior to closing the sale. After incurring the estimated required remediation costs, Western anticipates receiving net proceeds from the sale and remediation of approximately \$17 million.



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