

**Western Forest Products Inc.**

2011 Third Quarter Report

---

November 10, 2011

**To our Shareholders,**

We are pleased to announce another good quarter, both in terms of our financial results and our strong operating performance. Again, I would like to emphasize that we are achieving this despite the less than favourable market conditions that persist in our industry.

The following are some key highlights from our third quarter performance:

- EBITDA of \$18.1 million in the quarter, a significant increase from the \$11.8 million achieved in the third quarter of 2010 and the eighth consecutive quarter that we have achieved positive EBITDA
- Net debt at \$63.2 million, a reduction of \$36.6 million from the beginning of the year. We had liquidity of \$116.0 million at the end of the quarter, more than adequate for our immediate needs.
- Lumber production 3% higher than the previous quarter and 27% higher than the same quarter a year ago.
- We re-started the Duke Point sawmill which had been shut for market reasons since October 2009. All eight of our mills are now operating. This will help with our strategy of aligning customer demand with production.

We were able to generate EBITDA of \$18.1 million despite the relative strength of the Canadian dollar against the US dollar and the Japanese Yen. From time to time, Western mitigates its foreign exchange risk by matching sales transactions with forward currency contracts in both US dollars and Japanese Yen. The Yen exchange rate strengthened against the Canadian dollar by 11.3% over the course of the third quarter of 2011, which created an unrealized mark-to-market loss of \$6.5 million on our forward Yen contracts. Excluding this item, EBITDA would have been \$24.6 million for the third quarter of 2011.

Much of the EBITDA improvement in 2011 compared to last year is driven by the increased levels of production in both our manufacturing and logging operations. Increased margins and sales volumes of our external log sales were key drivers to our results. Log demand and prices for both domestic and export logs were strong in the quarter. While log exports remain a relatively minor product line for Western, the use of log exports has allowed us to increase our log harvesting which has generated additional logs for our lumber mills, our domestic log customers and additional employment for our employees and contractors. Higher lumber production has led to increased volumes of chips, but a softening in the pulp markets has meant a decline in chip prices.

In terms of the outlook for the balance of the year, a note of caution is appropriate with respect to current developments in the Chinese and North American lumber markets. The Chinese government has restricted access to credit which has slowed the pace of growth of demand as reflected in recent figures released by China. This has led to higher inventory levels and weakening prices. However, our diverse product mix means we are less exposed than others in this market, but this slow down will hit all suppliers. In anticipation of a weakening market in China we have built a reasonable order file of higher value commodity products for the domestic market. We believe that the pull back in China is temporary and still see significant long term opportunities in that market.

Little has changed in North America. New housing starts for the current year are now projected to be 570,000, well short of what we had expected one year ago. We expect the stagnant housing situation to continue into 2012, and where possible we are shifting our business more to the higher value Canadian specialty commodity and timber markets and aim to retain as much flexibility as possible.

The fourth quarter is typically the slowest quarter of the year for western red cedar and we will keep our inventories in balance for what we anticipate to be a strong start for 2012.

Third quarter volumes to Japan were down from the previous quarter due to infrastructure and supply related disruption after the Tsunami, but early October indications are that many of these issues have been resolved and we expect more robust sales in the fourth quarter.

Domestic demand for sawlogs and veneer logs is expected to remain stable as customers focus on building inventory for 2012. The pullog market is currently oversupplied but the surplus should be reduced with seasonally lower harvest volume through the winter period.

I have highlighted below some key events since my last letter to you:

- We still expect to meet the targeted production in our lumber manufacturing and logging operations of 820 million board feet of lumber and 5.8 million cubic metres of log harvest, respectively, for 2011.
- I recently met with many of our long term customers during a trip to Japan. The news is encouraging. Housing starts in Japan at the end of the third quarter were better than anticipated, and we now expect the outlook to be improved for the fourth quarter and thereafter. We ship approximately 37% of our lumber (by value) to Japan.
- We are participating in the trade visits to China and Japan led by the Premier of the Government of British Columbia, Christy Clark, with the Provincial Minister of Forests, Lands and Natural Resource Operations, Steve Thomson, and the Federal Minister of Natural Resources, Joe Oliver. Western has been a strong supporter of these trade missions and sees them as extremely important in securing new market opportunities.
- Our operations continue to develop the margin improvement programs outlined in my previous report to you in order to extract the maximum margin from our existing business. This is essential in order to sustain our profitability in the continuing uncertain business environment and weakness in our traditional markets.
- We have started our strategic capital spending with a planer trimmer upgrade at Cowichan Bay sawmill which is expected to be completed by year end.
- In October 2011 we announced the sale of TFL 60 to Taan Forest Limited Partnership, which is expected to close by the end of the year. Taan is a partnership of the Council of the Haida Nation and Haida Enterprise Corporation, the business arm of the Haida Nation.

Given the challenging environment in which we are operating I am encouraged by Western's strategic repositioning in the market place, continuously improving cost structure and financial health.

I look forward to updating you on our full year results and activities in my next letter to you, and will provide a further report on our strategic capital plan direction.

Dominic Gammiero

*Chairman and CEO*

Lee Doney

*Vice Chairman*

## Management's Discussion & Analysis

The following discussion and analysis reports and comments on the financial condition and results of operations of Western Forest Products Inc. (the "Company", "Western", "us", "we", or "our"), on a consolidated basis, for the three and nine months ended September 30, 2011 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 unaudited condensed consolidated interim financial statements for the first, second and third quarters of 2011 and with the audited annual consolidated financial statements and management's discussion and analysis ("MD&A") for the year ended December 31, 2010 (the "2010 Annual Report"), all of which can be found on the System for Electronic Document Analysis and Retrieval ("SEDAR"), at <http://www.sedar.com>.

The Company has prepared the unaudited condensed consolidated interim financial statements in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*, and IFRS 1, *First-Time Adoption of IFRS*. For comparative purposes all financial statement amounts related to the three, six and nine month periods ended March 31, June 30, and September 30, 2010 and the year ended December 31, 2010 have been restated in accordance with IFRS.

Reference is also made to EBITDA<sup>1</sup>. EBITDA is defined as operating income (loss) prior to operating restructuring costs and other income (expenses), plus amortization of property, plant and equipment, amortization of intangible assets, the reversal of impairments of intangible assets, and the change in fair value adjustments to 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, impairments, reversals of impairments 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, operating restructuring costs are not expected to occur on a regular basis and 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 IFRS 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 (loss). EBITDA is not a measure of financial performance under IFRS, and should not be considered as an alternative to measures of performance under IFRS. 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.

This management's discussion and analysis 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 the MD&A in our 2010 annual report, and those referenced in the MD&A in this quarterly 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.

---

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

Unless otherwise noted, the information in this discussion and analysis is updated to November 10, 2011. Certain prior period comparative figures may have been reclassified to conform to the current period's presentation. All financial references are in millions of Canadian dollars unless otherwise noted.

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
<i>(millions of dollars except per share amount)</i>				
Sales	\$ 233.5	\$ 175.5	\$ 633.0	\$ 495.3
EBITDA	18.1	11.8	48.2	42.9
EBITDA as % of sales	7.8%	6.7%	7.6%	8.7%
Operating income before restructuring items and other income (expenses)	11.5	6.9	28.2	24.0
Net income from continuing operations	7.9	2.4	19.5	22.2
Net income	7.6	2.1	18.7	21.0
Basic and diluted earnings per share (in dollars)	\$ 0.02	\$ -	\$ 0.04	\$ 0.05

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

## Overview

### Third quarter 2011

Our third quarter results were positive even though lumber markets in the United States ("US") remain well below historical trend levels and a meaningful recovery of the US housing market does not yet appear to be on the horizon. We have benefited from participating in the growth in the Chinese market for lumber partially countering the steep decline in US markets. However, current indications are that growth in the Chinese market appears to be slowing. Our operating environment has been further challenged by the continuing strength of the Canadian dollar relative to the US dollar, as a high proportion of our sales are denominated in US dollars. In this environment our focus will be on the management of our working capital levels, as well as continued cost reduction programs and further enhancing the operating efficiencies of all of our activities.

Western generated EBITDA of \$18.1 million for the quarter, an increase from the \$11.8 million earned in the same quarter last year but lower than the \$21.9 million reported in the second quarter of 2011. The third quarter saw increases in production of logs, lumber and by-products over both the previous quarter in 2011 and the same quarter in 2010. Log sales revenues were particularly strong this quarter, driven by a strong domestic pulp mill demand and, to a lesser degree, export demand for logs. Lumber and chip sales revenues were also higher than the same quarter in 2010, which is mainly a function of higher volumes, as prices of lumber and chips were not significantly different over the two periods. While our EBITDA margin for the quarter was higher than the third quarter of 2010, it was adversely impacted by the negative effect on revenues of the stronger Canadian dollar relative to the US dollar, mark-to-market losses on Japanese Yen forward contracts and increased freight charges.

Western mitigates its foreign exchange risk associated with sales transactions denominated in US dollars and Japanese Yen by utilizing forward currency transactions available to it under a facility provided by Brookfield Asset Management Inc. ("BAM"). At September 30, 2011 Western had obligations to sell an aggregate Yen 5,550 million at average rate of 79.28 yen per C\$. The Yen exchange rate strengthened against the Canadian dollar by 11.3% over the course of the third quarter of 2011 (from a rate of 83.61 Yen per C\$, to 74.13) which created an unrealized mark-to-market loss of \$6.5 million on the contracts which was included in EBITDA. Excluding this item, EBITDA would have been \$24.6 million for the third quarter of 2011.

Net income for the third quarter of 2011 was \$7.6 million, which is an increase of \$5.5 million over net income of \$2.1 million reported a year earlier, but a decline from the net income of \$12.1 million reported in the previous quarter. Our third quarter 2011 net income was higher than the same quarter of 2010 primarily because of improved EBITDA and lower interest costs, partially offset by an asset impairment recognized in the current quarter of \$1.7 million.

Our liquidity position at September 30, 2011 increased to \$116.0 million from \$111.7 million at the end of the second quarter of 2011, and from \$66.2 million at September 30, 2010.

*Year to date, September 30, 2011*

Net income for the first nine months of 2011 was \$18.7 million, which compares to our net income reported in the same period in 2010 of \$21.0 million. The income in 2010 includes a net one-time gain of \$9.4 million in the first quarter of 2010 due to the reorganization of WFP Forest Products Limited. Excluding the impact of this gain, the net income for 2011 was higher than 2010 by \$7.1 million, with the majority of the increase due to higher EBITDA and the lower interest charges that resulted from our lower average debt levels in the current nine month period compared to the same period in 2010.

On February 11, 2011, we completed the sale of certain non-core properties to TimberWest Forest Corp. for a purchase price of \$21.9 million. The sale included properties located in the southern portion of Vancouver Island, near Jordan River. These properties, which encompass approximately 7,678 hectares, are situated in the land districts of Renfrew and Malahat. The net proceeds from the sale were used to pay down the Company's long-term debt in accordance with lending agreements. A net loss of \$1.1 million was recognized on this disposal in the first quarter of 2011.

On October 11, 2011 Western announced that it had reached an agreement to sell 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, Western will receive net proceeds of approximately \$11.6 million and certain ongoing rights to cedar logs harvested by Taan. Taan will assume substantially all of the obligations of Western on Haida Gwaii. The sale is expected to be completed before the end of the year with the transaction being recognized in the fourth quarter. However, an impairment of \$1.7 million has been recognized on the net assets in this quarter. 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 long term operating rates at our eight lumber mills. Proceeds from the sale will be used to pay down the Company's revolving term debt.

## Operating Results

Sales	Three months ended		Nine months ended	
	September 30,		September 30,	
<i>(millions of dollars)</i>	2011	2010	2011	2010
Lumber	\$ 141.2	\$ 123.7	\$ 413.7	\$ 357.0
Logs	77.3	39.1	171.4	100.2
By-products	15.0	12.7	47.9	38.1
Total sales	\$ 233.5	\$ 175.5	\$ 633.0	\$ 495.3

*Third quarter 2011*

Lumber sales revenues increased by 14% when compared to the third quarter of 2010 primarily due to higher shipment volumes. Despite the uncertain global economic conditions, market demand for the majority of our lumber products has shown a gradual improvement. Lumber shipment volumes increased by 27% to 209 million board feet in the third quarter of 2011 from 165 million board feet in the third quarter of 2010. The geographic destination of the lumber was relatively consistent with the prior year, with 37% of lumber volume being shipped within Canada, 21% going to Japan, 24% to China, and 12% to the US.

Lumber product prices in the third quarter of 2011 did not change significantly when compared to the same period last year. However, in the third quarter of 2011, our overall average lumber price realized was lower at \$676 per thousand board feet, compared to \$750 in the same quarter of 2010 due to our mix of sales. Our sales mix in the current quarter contained more, lower priced hemlock which was sold into China following the start up of the Ladysmith and Nanaimo mills. The reduction is also due to the effects of the stronger Canadian dollar on US dollar denominated revenues and losses recorded on Yen forward contracts.

Log sales revenues in the third quarter of 2011 increased by 98% compared to the same period last year. The increase is due to a 68% increase in the volume of logs sold and average log prices realized in the third quarter of 2011 being 11%, or \$7 per cubic metre, higher than a year ago. Overall log demand for the quarter was

strong, relative to prior quarters, in both our domestic and export markets. Increases in volumes sold were achieved in our pulp log, cedar and shingle log sales in North American markets as well as export sales to Korea and China. Log prices have increased since the third quarter of 2010 largely because of a strong domestic pulplog market and supply shortages for most log species. Supply shortages have resulted from severe winter weather conditions through the first half of the year, with snow pack restricting harvest levels.

By-product revenues increased by \$2.3 million, or 18%, in the current quarter compared to the third quarter of 2010, mainly because of increased chip production. Chip production in the third quarter of 2011 increased by 23% over 2010 largely due to increased lumber production at our sawmills. Partially offsetting the increase in volumes sold was the impact of lower average chip prices realized in the current quarter compared to 2010. Prices realized for our chips sold under fibre agreements with certain of our customers are based on a chip pricing formula which is a function of pulp prices and the mix of chips sold. Pulp prices were lower this year by an average of approximately 5% and this resulted in lower chip prices. In addition, the mix of chips sold changed with proportionately more of the lower priced cedar chips being sold this quarter compared to 2010.

EBITDA of \$18.1 million reported for the third quarter of 2011, which compares to the EBITDA reported in the same quarter last year of \$11.8 million, but is a decline of \$3.8 million from the \$21.9 million earned in the second quarter of 2011. The EBITDA result for the third quarter of 2011 reflects increased operating levels, higher sales volumes for most products and a more favorable mix of sales compared to the third quarter of 2010. However, these positive variances were offset by the negative impacts of foreign exchange, higher freight costs and higher selling and administrative expenses in the current quarter.

As previously mentioned, our operating results were negatively impacted by an approximate 6% strengthening in the value of the Canadian dollar relative to the US dollar from the third quarter of 2010, which reduced our Canadian dollar proceeds received on US dollar denominated sales (the major share of our lumber sales are denominated in US dollars, including those to China). In addition, we recognized unrealized exchange losses on Yen forward exchange contracts in the quarter of \$6.5 million as a result of the significant strengthening of the Yen against the Canadian dollar over the course of the third quarter of 2011. Western mitigates its foreign exchange risk associated with sales transactions denominated in US dollars and Japanese Yen by utilizing forward currency transactions available to it under a facility provided by BAM. At September 30, 2011 Western had obligations to sell an aggregate Yen 5,550 million at average rate of 79.28 yen per C\$. The Yen exchange rate strengthened against the Canadian dollar by 11.3% over the course of the third quarter of 2011 (from a rate of 83.61 Yen per C\$, to 74.13) which created the unrealized mark-to-market loss on the contracts which was included in EBITDA. Excluding this item, EBITDA would have been \$24.6 million for the third quarter of 2011.

Total freight costs were \$23.8 million in the third quarter of 2011, which compared to the third quarter of 2010 cost of \$15.4 million. Shipment volumes of lumber were higher in the current quarter which accounts for the majority of the \$8.4 million increase. The balance of the increase results from the impact of rising oil prices on general freight rates.

Selling and administration costs increased by \$0.6 million to \$6.4 million in the current quarter compared to \$5.8 million in the same quarter of 2010, mainly because of increased salary costs. The increase in salary costs is primarily because of the inclusion of performance-based bonus accruals expected for this year.

The operating results for the third quarter of 2011 incorporated temporary shutdown costs that were \$8.8 million less than those incurred in 2010, as production was increased to meet demand. Lumber production was 27% higher in the third quarter of 2011 compared to the third quarter of 2010, and our sawmills operated at 86% of capacity (on a shifts available basis) in the third quarter of 2011 compared to 60% of capacity in the same quarter of 2010. The majority of this increase in operating capacity relates to the Nanaimo and Ladysmith mills, which ran for the third quarter of 2011, but were idle in the same quarter in 2010. Excluding the recently started mills of Nanaimo, Duke Point and Ladysmith, our mill productivity, measured on a volume produced per shift basis, improved 1.4% for the third quarter of 2011 compared to the same period in 2010.

#### *Year to date, September 30, 2011*

Total sales revenues for the first nine months of 2011 were \$633.0 million, an increase of 28% over the sales revenues for the same period in 2010. Lumber, log and by-product sales were higher in the current nine month period by 16%, 71% and 26% respectively. Higher shipment volumes for all primary product categories, logs in particular, contributed to most of the increase. This increase was a function of stronger market demand for logs and lumber. Our lumber production was 17% higher in the first nine months of 2011 compared to 2010, which led to greater chip production levels thus increasing by-product revenues. Partially offsetting these was the

negative impact on revenues of the stronger Canadian dollar in the current nine month period compared to 2010. The Canadian dollar was, on average, 6% stronger relative to the US dollar over the respective periods.

EBITDA for the nine months to September 30, 2011 was \$48.2 million, which is \$5.3 million more than the EBITDA for the same period of 2010 of \$42.9 million. The benefit of the revenue increases described above and the favourable impact on fixed costs resulting from significantly increased operating rates in both our sawmills and logging operations were partially offset by increases to our cost of sales including log costs, higher freight costs and selling and administrative costs over the respective periods.

## Non-operating income and costs

Finance costs decreased from \$3.5 million in the third quarter of 2010 to \$1.5 million in the current quarter. This decrease is primarily attributable to a reduction in the outstanding debt amount over the respective periods, resulting from the proceeds of non-core asset sales being used to pay down debt subsequent to September 30, 2010. Also contributing to this reduction is the benefit of lower interest rates negotiated in the amendments to the loan agreements effected in late December 2010.

Other expenses of \$1.9 million for the third quarter of 2011 compares to other expenses of \$0.3 million incurred in the third quarter of 2010. The majority of this increase relates to an impairment on assets recognized in the current quarter of \$1.7 million. This impairment was required on assets included in the expected sale of TFL 60 discussed in the Overview section of this report.

Other significant non-operating transactions occurred in the first quarter of 2011, including a gain on the sale of an equity interest in certain real estate properties of \$2.4 million (for further details see *Related Parties* on page 13), an expense incurred of \$2.5 million to amend the terms of certain contractual arrangements, and other items totaling expenses of \$0.4 million. In comparison, the first quarter of 2010 included other income of \$10.4 million, which primarily related to a receipt in January 2010 of \$8.9 million, being the balance of the proceeds related to the establishment of a jointly-owned entity in 2009 with Brookfield Properties Limited ("BPL"), a company related to BAM.

## Financial Position and Liquidity

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
<i>(millions of dollars except where noted)</i>				
Cash provided by (used in) operating activities	\$ (1.2)	\$ 18.4	\$ 24.3	\$ 31.9
Cash provided by (used in) investing activities	(3.1)	7.5	18.4	4.7
Cash provided by (used in) financing activities	3.7	(19.3)	(43.6)	(35.5)
Cash used to construct capitalized logging roads	(3.6)	(1.9)	(6.7)	(6.1)
Cash used to acquire property, plant, and equipment	(2.8)	(1.3)	(6.2)	(2.1)
			September 30, 2011	December 31 2010
Total liquidity <sup>(1)</sup>			\$ 116.0	\$ 84.6
Net debt <sup>(2)</sup>			63.2	99.8
Financial ratios:				
Current assets to current liabilities			2.27	2.50
Net debt to capitalization <sup>(3)</sup>			0.16	0.23

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

<sup>(2)</sup> 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.

<sup>(3)</sup> Capitalization comprises net debt and shareholders equity

Cash used in operating activities in the third quarter of 2011 amounted to \$1.2 million compared to cash provided of \$18.4 million in the same period last year. Prior to changes in the levels of working capital at the end of the respective quarters, cash from operations was relatively consistent over the two quarters. In the current quarter, however, investment in working capital increased by \$18.1 million whereas investment in working capital reduced by \$8.3 million over the same period in 2010. This increase is primarily related to the respective levels of inventory over the two periods. Inventory levels increased by \$13.9 million in the third



quarter of 2011 mainly as a result of higher log volumes at the end of the quarter, whereas in 2010 inventories were reduced over the quarter by \$12.0 million. In 2010 logging operations were curtailed significantly in the third quarter because of severe fire hazard conditions whereas operations were only minimally impacted by such conditions in 2011. There was also a need to build up log inventories this year as our mills are running at higher operating rates, and also the log sales market continues to be strong this year.

Cash used for additions to property, plant and equipment in the third quarter of 2011 was \$6.4 million compared to \$3.2 million in the third quarter of 2010. In the current quarter, additions comprised \$3.6 million of additions to logging roads and bridges and \$2.8 million of other property and equipment, which primarily related to equipment replacements and upgrades.

In the third quarter of 2011, the Company paid down its long-term debt by \$3.3 million and drew on its revolving credit facility by \$8.2 million. The \$3.3 million used to pay down debt was generated from the proceeds of non-core asset sales. For the nine months to September 30, 2011 the Company has repaid long-term debt by \$47.1 million. Of this amount, \$31.9 million was from the proceeds of non-core assets sold, \$5.2 million from the cash received as reimbursement by the Province of British Columbia (for costs incurred by Western with respect to the Forestry Revitalization Plan timber take-back areas), and the balance of \$10.0 million from cash generated from operations. In the first nine months of 2010, the revolving credit facility was paid down by a net \$15.3 million from cash generated by operations, and the non-revolving term facility was paid down by \$13.0 million from asset sales.

At September 30, 2011, Western's total liquidity had increased to \$116.0 million from \$111.7 million at the end of the second quarter and from the \$66.2 million of liquidity available at September 30, 2010. Liquidity is comprised of cash of \$3.4 million and availability under the secured revolving credit facility of \$96.7 million and \$15.9 million under the revolving term loan at September 30, 2011. The increase in the liquidity availability compared to September 30, 2010 is largely a function of the improved availability under the amended financing agreements and improved cash generated from operations.

## **Changes in Accounting Policies**

Effective January 1, 2011, Canadian publicly listed entities were required to prepare their financial statements in accordance with IFRS. Due to the requirement to present comparative financial information, the effective transition date for the Company is January 1, 2010. Full disclosure of the Company's accounting policies in accordance with IFRS can be found in Note 2 to the Unaudited Condensed Consolidated Interim Financial Statements for the Three and Nine Months ended September 30, 2011. The interim financial statements also include reconciliations of the previously disclosed comparative periods' financial statements prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") to IFRS as set out in Note 4.

### *New Standards and Interpretations*

In 2011, the IASB has issued the following new or amended IFRSs which are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted, with the exception of IFRS 13 which is effective prospectively from January 1, 2013:

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* ("IFRS 9") was issued in November 2009 and will replace IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 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 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 10 *Consolidated Financial Statements* replaces the guidance in IAS 27 *Consolidated and Separate Financial Statements* ("IAS 27") and SIC-12 *Consolidation – Special Purpose Entities*. 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 involvement that exposes 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 (Level 3), 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 balance sheet 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
- 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, and the Company has not yet completed the process of assessing the impact that they will have on its financial statements or whether to early adopt any of the new requirements.

## **Evaluation of Disclosure Controls and Procedures**

As required by National 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, 2010. 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 interim 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 interim filings are being prepared.

There were no changes in the controls which materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting during the third quarter of 2011.

## **Outlook and Strategy**

The worldwide economic outlook has moved from a sense of general uncertainty to one of greater pessimism as reflected in the ongoing stock market turmoil, poor US economic news, and the unresolved European sovereign debt crisis. The US continues to have high unemployment, slowing household spending and a depressed housing market. The Chinese economy, which has been a key driver of global growth, is also showing some signs of slowing down.

While commodity lumber product prices are improved from the low levels of 2009, they remain historically weak and are well below normalized levels. The US housing market continues to be depressed, hampered by high unemployment, and a significant housing foreclosure inventory. Although China has been dealing with an overheated economy, it has emerged as a major source of demand for commodity lumber to be used in industrial and remanufacturing purposes. Demand for lumber in China has partially replaced the significant decline in US demand. Current indications are that the rate of growth in the China market has slowed down in the latter part of the third quarter and into the fourth quarter, reflecting high inventories. We are cautious about the repercussions of this decline in growth and the impact it could have on the industry in general. However, China continues to present an opportunity for Western to improve selling prices of low grade lumber and absorb volume that would otherwise be sold in a weak North American market. Longer term, we expect China to provide an opportunity for Western for higher grades of lumber, as Chinese building codes and practices become more accepting of construction grade lumber for home construction. However, currently the overall commodity lumber market remains depressed and is likely to continue so until the US market picks up.

The Sendai Tohoku earthquake in Japan last March was one of the most devastating natural disasters of the century, with housing starts only recently showing signs of improvement. However, given the number of properties that were destroyed, there is little doubt that significant rebuilding will need to take place. Current indications are that the infrastructure repairs that are in progress have reached the point where building and construction work is ready to commence. Actual housing starts in Japan for August in 2011 were approximately 5% higher than August in 2010, and our customers are currently more optimistic and shipments to Japan are expected to increase in 2012. The market for cypress also appears to be better than expected with most of our fourth quarter production committed.

In our niche markets, demand for appearance grade products in North America continues at a low level and demand from Europe has slowed as a result of their financial crisis and is expected to remain weak. Currently,

a trade action has been launched by the Australian government claiming that certain countries have been dumping their lumber products into the Australian market at prices below their own domestic levels. Western has been named in this claim. It is too early to tell what the result of this action will be; however, we do not expect this to be a material issue given the relatively low shipment volumes involved for Western. Approximately 50% of our niche sales are made within Canada, much of which is used for remanufacture in the US door, window and molding products market.

We are entering the seasonally slow period of the year for cedar lumber demand. While current demand has been steady, distributors continue to only buy fill-in volume and operate at very lean inventory levels. If general economic conditions in US improve we expect distributors to be more aggressive in the future but for now demand will likely tail off through the fourth quarter in line with the normal seasonal adjustment. We also expect demand in Europe to remain weak.

Domestic demand for sawlogs and veneer logs is expected to remain stable as customers focus on building inventory for 2012. The pulplog market is currently oversupplied but the surplus will be reduced with lower harvest volume through the winter season. In China, log inventories are high, ports are congested and access to credit is more restricted which is leading to a softening of the market.

Our balance sheet continues to be strong, with low leverage, strong liquidity and no term debt maturities until June 2013. This strength provides us the financial stability that we need to invest in our business and pursue high-return growth projects. Our recently announced \$125 million dollar reinvestment program is expected to be funded from operational cash flows, and will initially be focused on quick payback cost reduction projects in our sawmills. We have started our strategic capital spending with a planer trimmer upgrade at Cowichan Bay sawmill which is expected to be complete by the end of November. This will increase the speed of the planer, allowing it to keep up with our growing sawmill production.

We have also embarked on a \$25 million non-capital margin improvement program. The program is focused on reducing costs and extracting margin from our existing products without capital investment.

We continue to hold significant non-core assets and will pursue sale opportunities related to these assets should the right conditions present themselves. However, our net debt and liquidity position has improved significantly over the past year. Any proceeds from such sales will first be used to reduce the revolving term loan, with any surplus providing additional liquidity.

As noted earlier, Western announced that it had reached an agreement to sell TFL 60 in Haida Gwaii for net proceeds of \$11.6 million and the sale is expected to close before the end of the year.

## **Risks and Uncertainties**

The business of the Company is subject to a number of risks and uncertainties, including those described in the 2010 Annual Report which can be found on SEDAR, at <http://www.sedar.com>. Any of the risks and uncertainties described in the above-noted document could have a material adverse effect on our operations and financial condition and cash flows and, accordingly, should be carefully considered in evaluating Western's business.

## **Outstanding Share Data**

As of November 10, 2011 there were 128,625,623 Common Shares and 338,945,860 Non-Voting Shares issued and outstanding. Brookfield Special Situations Management Limited ("BSSML") controls and directs 49% 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 sole discretion, provided that the Board of Directors is at that time of the opinion that to do so would not have a material adverse effect on the Company's business, financial condition or business prospects.

Western has reserved 10,000,000 Common Shares for issuance upon the exercise of options granted under the incentive stock option plan. On February 23, 2011 1,700,000 options were granted under the plan. As of November 10, 2011, 6,441,795 options were outstanding under the Company's incentive stock option plan.

## **Related Parties**

By virtue of the BAM voting arrangements with BSSML, BAM is related to the Company. Western has certain arrangements with entities related to BAM to acquire and sell logs, lease certain facilities, provide access to roads and other areas, and acquire other services including insurance, the provision of a foreign exchange

facility, and the services of the Chief Executive Officer all in the normal course and at market rates or at cost. During the third quarter of 2011, the Company paid entities related to BAM \$5.4 million (\$12.1 million year-to-date), and received income from related entities of \$2.6 million (\$4.6 million year-to-date) in connection with these arrangements.

On January 4, 2011, the Company exercised its option to sell its equity interest in WFP Forest Products Ltd., the jointly-owned entity established in 2009 between the Company and BPL, receiving \$2.4 million as consideration for the sale of its interest, and the right of first offer on certain land was extinguished.

### **Public Securities Filings**

Readers may access other information about the Company, including the Annual Information Form and additional disclosure documents, reports, statements and other information that are filed with the Canadian securities regulatory authorities, on SEDAR at [www.sedar.com](http://www.sedar.com).

### **On behalf of the Board of Directors**

Dominic Gammiero  
Chairman

Lee Doney  
Vice-Chairman

Vancouver, BC,  
November 10, 2011

## Management's Discussion and Analysis – Appendix A

### Summary of Selected Results for the Last Eight Quarters (Unaudited)

	Financial results prepared under:							
	IFRS							Canadian GAAP
	2011			2010				2009
	3 <sup>rd</sup>	2 <sup>nd</sup>	1 <sup>st</sup>	4 <sup>th</sup>	3 <sup>rd</sup>	2 <sup>nd</sup>	1 <sup>st</sup>	4 <sup>th</sup>
<i>(millions of dollars except per share amounts and where noted)</i>								
<b>Average Exchange Rate – Cdn \$ to purchase one US \$</b>	0.980	0.968	0.986	1.013	1.039	1.029	1.040	1.056
<b>Sales</b>								
Lumber	141.2	143.5	129.0	118.1	123.7	131.1	102.2	96.3
Logs	77.3	57.8	36.3	38.8	39.1	36.6	24.5	32.5
By-products	15.0	17.4	15.5	15.7	12.7	13.8	11.6	10.5
<b>Total sales</b>	<b>233.5</b>	<b>218.7</b>	<b>180.8</b>	<b>172.6</b>	<b>175.5</b>	<b>181.5</b>	<b>138.3</b>	<b>139.3</b>
<b>Lumber</b>								
Shipments – millions of board feet	209	210	183	168	165	189	147	140
Price – per thousand board feet	676	684	705	703	750	694	695	688
<b>Logs</b>								
Shipments – thousands of cubic metres	1,078	755	504	646	642	640	414	528
Price – per cubic metre*	68	72	68	60	61	57	59	62
<b>Selling and administration</b>	6.4	6.7	6.6	7.6	5.8	5.8	5.4	5.6
<b>EBITDA</b>	18.1	21.9	8.2	5.8	11.8	21.9	9.3	2.3
Amortization	(6.0)	(6.7)	(5.6)	(5.2)	(5.5)	(6.9)	(5.9)	(7.2)
Changes in fair value of biological assets	(0.6)	(0.5)	(0.6)	(2.7)	0.6	(0.6)	(0.7)	-
Reversal of impairment	-	-	-	18.5	-	-	-	-
Operating restructuring items	(0.3)	(0.3)	(0.3)	(0.1)	(0.6)	(0.9)	-	0.3
Finance costs	(1.5)	(1.8)	(1.9)	(2.8)	(3.5)	(3.4)	(3.2)	(3.2)
Other income (expenses)	(1.9)	(0.1)	(0.5)	6.3	(0.3)	0.3	10.4	5.1
Income tax recovery (expense)	0.1	(0.2)	-	0.6	(0.1)	(0.3)	(0.2)	-
<b>Net income (loss) from continuing operations</b>	7.9	12.3	(0.7)	20.4	2.4	10.1	9.7	(2.7)
Net loss from discontinued operations	(0.3)	(0.2)	(0.3)	(0.3)	(0.3)	(0.3)	(0.6)	(0.4)
<b>Net income (loss)</b>	7.6	12.1	(1.0)	20.1	2.1	9.8	9.1	(3.1)
<b>EBITDA as % of sales</b>	7.8%	10.0%	4.5%	3.4%	6.7%	12.1%	6.7%	1.7%
<b>Earnings per share:</b>								
Net income (loss), basic and diluted	0.02	0.03	-	0.04	-	0.02	0.02	(0.01)
Net income (loss), from continuing operations basic and diluted	0.02	0.03	-	0.04	0.01	0.02	0.02	(0.01)

\* Note - the log revenue used to determine average price per cubic metre in Q3, Q2 and Q1 of 2011 was adjusted to reflect revenues recognized of \$3.7 million, \$3.4 million and \$2.0 million, respectively, associated with shipping costs arranged in the period to enable comparability of unit prices.

The presentation of the most current seven quarters above as required under IFRS reporting rules has not materially impacted the comparability of these quarters with the previous quarter that was prepared under Canadian GAAP rules, other than the reversal of the impairment of \$18.5 million as indicated in the fourth quarter of 2010.

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 North American markets, has

historically tended to be higher. Logging activity may also vary depending on weather conditions such as rain, snow and ice in the winter and the threat of forest fires in the summer.

The category of "Other income (expenses)" comprises gains on the sale of various non-core assets and other receipts which can be unpredictable in their timing. More material transactions of this nature occurred in the first and fourth quarters of 2010, and the fourth quarter of 2009. The downturn in the forest products industry that was experienced most significantly in 2008 and 2009 brought associated production curtailments, which are reflected most significantly in the results of the fourth quarter of 2009 and the first quarter of 2010.

**Western Forest Products Inc.**

---

Unaudited Condensed Consolidated Interim Financial Statements

For the three and nine months ended September 30, 2011 and 2010



## Western Forest Products Inc.

### Condensed Consolidated Statements of Financial Position

(Expressed in millions of Canadian dollars) (unaudited)

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 3.4	\$ 5.1
Trade and other receivables	79.3	58.7
Inventory <sup>(Note 9)</sup>	143.1	129.6
Prepaid expenses and other assets	6.7	4.8
	<u>232.5</u>	<u>198.2</u>
Non-current assets:		
Property, plant and equipment <sup>(Note 10)</sup>	190.7	205.4
Intangible assets <sup>(Note 10)</sup>	127.1	132.8
Biological assets <sup>(Note 11)</sup>	60.3	77.7
Other assets	11.7	13.8
	<u>\$ 622.3</u>	<u>\$ 627.9</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 76.6	\$ 61.6
Revolving credit line <sup>(Note 12)</sup>	8.2	-
Silviculture provision <sup>(Note 14)</sup>	11.5	11.5
Discontinued operations <sup>(Note 7)</sup>	6.2	6.2
	<u>102.5</u>	<u>79.3</u>
Non-current liabilities:		
Long-term debt <sup>(Note 13)</sup>	58.4	104.9
Silviculture provision <sup>(Note 14)</sup>	17.8	15.8
Other liabilities <sup>(Note 15)</sup>	37.8	23.3
Deferred revenue	68.9	70.4
	<u>285.4</u>	<u>293.7</u>
Shareholders' equity:		
Share capital - voting shares <sup>(Note 17)</sup>	412.3	412.3
Share capital - non-voting shares <sup>(Note 17)</sup>	187.5	187.5
Contributed surplus	3.3	3.0
Revaluation reserve	23.9	23.9
Deficit	(290.1)	(292.5)
	<u>336.9</u>	<u>334.2</u>
	<u>\$ 622.3</u>	<u>\$ 627.9</u>

#### Commitments and Contingencies <sup>(Note 18)</sup>

See accompanying notes to these unaudited condensed consolidated interim financial statements

Approved on behalf of the Board:

"Dominic Gammiero"  
Chairman

"Lee Doney"  
Vice Chairman

## Western Forest Products Inc.

### Condensed Consolidated Statements of Comprehensive Income (Loss)

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Revenue	\$ 233.5	\$ 175.5	\$ 633.0	\$ 495.3
Cost and expenses:				
Cost of goods sold	190.1	146.4	511.1	404.5
Export tax	1.7	1.0	5.0	2.9
Freight	23.8	15.4	69.0	46.9
Selling and administration	6.4	5.8	19.7	17.0
	<u>222.0</u>	<u>168.6</u>	<u>604.8</u>	<u>471.3</u>
	<u>11.5</u>	<u>6.9</u>	<u>28.2</u>	<u>24.0</u>
Operating restructuring items <sup>(Note 20)</sup>	(0.3)	(0.6)	(0.9)	(1.5)
Other income (expenses) <sup>(Note 21)</sup>	(1.9)	(0.3)	(2.5)	10.4
<b>Operating income</b>	<u>9.3</u>	<u>6.0</u>	<u>24.8</u>	<u>32.9</u>
Finance costs	(1.5)	(3.5)	(5.2)	(10.1)
Income before income taxes	7.8	2.5	19.6	22.8
Income tax recovery (expense)	0.1	(0.1)	(0.1)	(0.6)
Net income from continuing operations	7.9	2.4	19.5	22.2
Net loss from discontinued operations <sup>(Note 7)</sup>	(0.3)	(0.3)	(0.8)	(1.2)
<b>Net income for the period</b>	<u>7.6</u>	<u>2.1</u>	<u>18.7</u>	<u>21.0</u>
<b>Other comprehensive income (loss)</b>				
Defined benefit plan actuarial gains (losses), net of tax	(14.7)	1.5	(16.3)	(14.2)
<b>Total comprehensive income (loss) for the period</b>	<u>\$ (7.1)</u>	<u>\$ 3.6</u>	<u>\$ 2.4</u>	<u>\$ 6.8</u>
Net income per share (in dollars):				
Basic and diluted earnings per share	0.02	-	0.04	0.05
Basic and diluted earnings per share - continuing operations	<u>0.02</u>	<u>0.01</u>	<u>0.04</u>	<u>0.05</u>
Weighted average number of shares outstanding (thousands)				
Basic	467,571	467,571	467,571	467,571
Diluted	474,013	476,313	473,646	475,405

See accompanying notes to these unaudited condensed consolidated interim financial statements

## Western Forest Products Inc.

### Condensed Consolidated Statements of Cash Flows

(Expressed in millions of Canadian dollars) (unaudited)

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Cash provided by (used in):				
Operating activities:				
Net income from continuing operations	\$ 7.9	\$ 2.4	\$ 19.5	\$ 22.2
Items not involving cash:				
Amortization of property, plant and equipment	5.1	4.7	15.6	15.9
Amortization of intangible assets	0.9	0.8	2.7	2.4
Loss on disposal of assets	-	0.4	1.1	-
Changes in fair value of biological assets	0.6	(0.6)	1.7	0.6
Finance costs	1.5	3.5	5.2	10.1
Other	0.9	(1.1)	0.9	(1.2)
	<u>16.9</u>	<u>10.1</u>	<u>46.7</u>	<u>50.0</u>
Changes in non-cash working capital items:				
Trade and other receivables	(3.8)	8.0	(24.0)	(15.3)
Inventory	(13.9)	12.0	(13.5)	(17.1)
Prepaid expenses and other assets	2.1	3.5	(1.9)	(2.0)
Silviculture provision	(0.1)	(2.3)	2.0	0.1
Accounts payable and accrued liabilities	(2.4)	(12.9)	15.0	16.2
	<u>(18.1)</u>	<u>8.3</u>	<u>(22.4)</u>	<u>(18.1)</u>
	<u>(1.2)</u>	<u>18.4</u>	<u>24.3</u>	<u>31.9</u>
Investing activities:				
Additions to property, plant and equipment	(6.4)	(3.2)	(12.9)	(8.2)
Proceeds on disposals of assets	3.3	10.7	31.3	12.9
	<u>(3.1)</u>	<u>7.5</u>	<u>18.4</u>	<u>4.7</u>
Financing activities:				
Changes in revolving credit facility	8.2	(6.2)	8.2	(15.3)
Interest paid	(1.2)	(2.5)	(4.6)	(7.2)
Repayment of long-term debt	(3.3)	(10.6)	(47.1)	(13.0)
Refinancing fees	-	-	(0.1)	-
	<u>3.7</u>	<u>(19.3)</u>	<u>(43.6)</u>	<u>(35.5)</u>
Cash provided by (used in) continuing operations	(0.6)	6.6	(0.9)	1.1
Cash used in discontinued operations	(0.3)	(0.3)	(0.8)	(1.2)
Increase (decrease) in cash and cash equivalents	(0.9)	6.3	(1.7)	(0.1)
Cash and cash equivalents, beginning of period	4.3	1.7	5.1	8.1
Cash and cash equivalents, end of period	<u>\$ 3.4</u>	<u>\$ 8.0</u>	<u>\$ 3.4</u>	<u>\$ 8.0</u>

See accompanying notes to these unaudited condensed consolidated interim financial statements

## Western Forest Products Inc.

### Condensed Consolidated Statements of Changes in Shareholders' Equity

(Expressed in millions of Canadian dollars) (unaudited)

	Share Capital	Contributed Surplus	Revaluation Reserve	Deficit	Total equity
Balance at January 1, 2010	\$ 599.8	\$ 2.7	\$ 23.9	\$ (325.5)	\$ 300.9
Net income for the period	-	-	-	21.0	21.0
Other comprehensive loss:					
Defined benefit plan actuarial losses recognized, net of tax	-	-	-	(14.2)	(14.2)
<b>Total comprehensive income for the period</b>	-	-	-	6.8	6.8
Share-based payment transactions recognized in equity	-	0.2	-	-	0.2
<b>Total transactions with owners, recorded directly in equity</b>	-	0.2	-	-	0.2
<b>Balance at September 30, 2010</b>	<b>\$ 599.8</b>	<b>\$ 2.9</b>	<b>\$ 23.9</b>	<b>\$ (318.7)</b>	<b>\$ 307.9</b>
Balance at January 1, 2011	\$ 599.8	\$ 3.0	\$ 23.9	\$ (292.5)	\$ 334.2
Net income for the period	-	-	-	18.7	18.7
Other comprehensive loss:					
Defined benefit plan actuarial losses recognized, net of tax	-	-	-	(16.3)	(16.3)
<b>Total comprehensive income for the period</b>	-	-	-	2.4	2.4
Share-based payment transactions recognized in equity	-	0.3	-	-	0.3
<b>Total transactions with owners, recorded directly in equity</b>	-	0.3	-	-	0.3
<b>Balance at September 30, 2011</b>	<b>\$ 599.8</b>	<b>\$ 3.3</b>	<b>\$ 23.9</b>	<b>\$ (290.1)</b>	<b>\$ 336.9</b>

See accompanying notes to these unaudited condensed consolidated interim financial statements

# Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

## 1. General Information

Western Forest Products Inc. ("Western" or the "Company") is a major integrated softwood forest products company domiciled in Canada, operating in the coastal region of British Columbia. The unaudited condensed consolidated interim financial statements of the Company as at September 30, 2011 and for the three and nine months ended September 30, 2011 and 2010 comprises 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.

These unaudited condensed consolidated interim financial statements ("interim financial statements") were approved by the Board of Directors on November 10, 2011.

## 2. Summary of Significant Accounting Policies

### (a) Statement of compliance and basis of presentation

The consolidated financial statements of the Company as at and for the year ended December 31, 2010 which were prepared under Canadian Generally Accepted Accounting Principles ("Canadian GAAP") are available on [www.sedar.com](http://www.sedar.com).

Effective January 1, 2011, the Company fully adopted International Financial Reporting Standards ("IFRS") as the basis for preparation of financial information and accounting.

These interim financial statements are for the three and nine months ended September 30, 2011. Because they are part of the first fiscal year accounted for under IFRS, they have been prepared in accordance with IAS 34, *Interim Financial Reporting* ("IAS 34"), and are covered by IFRS 1, *First-time Adoption of IFRS*. As a result, these interim financial statements may provide additional disclosure not normally expected in interim financial statements. These interim financial statements do not include all of the information required for full annual financial statements.

Reconciliations and descriptions of the effect of the transition to IFRS on the Company's financial position, financial performance and cash flows are provided in Note 4 -Transition to IFRS. This note includes reconciliations of equity and total comprehensive income for comparative periods and of equity at the date of transition reported under Canadian GAAP, to those reported for those periods and at the date of transition under IFRS. Certain disclosures related to the first time adoption of IFRS, including the equity and comprehensive income reconciliations from Canadian GAAP to IFRS as at December 31, 2010 and for the year then ended, are included in the Company's March 31, and June 30, 2011 interim financial statements. These interim financial statements should be read in conjunction with the March 31, 2011 and June 30, 2011 interim financial statements.

The preparation of interim financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires Management to exercise judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the interim financial statements, are disclosed in Note 3 - Critical Accounting Estimates and Judgements. Actual results may differ from these estimates.

The accounting policies set out below have been applied consistently to all periods presented in the interim financial statements and in preparing the opening IFRS statement of financial position at January 1, 2010 for the purposes of transition to IFRS.

### (b) Basis of measurement

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

- Biological assets are measured at fair value less costs to sell;
- Land within property, plant and equipment is measured at fair value;

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

- Liabilities for cash-settled share-based payment transactions are measured at fair value at each reporting period and liabilities for equity-settled share-based payment transactions are measured at fair value at grant date;
- Derivative financial instruments are measured at fair value; and
- The defined benefit liability is recognized as the net total of the plan assets, plus unrecognized past service cost, less the present value of the defined benefit obligation.

### (c) Consolidation

As part of its transition to IFRS, the Company elected not to restate business combinations that occurred prior to January 1, 2010.

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 September 30, 2011 are Western Lumber Sales Limited (which sells into the United States), Western Forest Products Japan Ltd. (formerly MacMillan Bloedel KK) (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 interim financial statements. Unrealized losses are also eliminated in the same way unless the transaction provides evidence of an impairment of the asset transferred.

### (d) 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 which is effective prospectively from January 1, 2013:

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* ("IFRS 9") was issued in November 2009 and will replace IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 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 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 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*. 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 SPEs in the scope of SIC-12. In addition, the consolidation procedures are carried forward substantially unmodified from IAS 27 (2008).

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

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 involvement that exposes 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 (Level 3), 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 balance sheet 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
- 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.

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

- 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, and the Company has not yet completed the process of assessing the impact that they will have on its financial statements or whether to early adopt any of the new requirements.

### *(e) 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.

### *(f) Foreign currency translation*

#### *(i) Functional and presentation currency*

These interim 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.

#### *(ii) Transactions and balances*

Foreign currency transactions are translated into Canadian dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at balance sheet date exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in net income (loss) for the period. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the 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.

### *(g) 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 balance sheet 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 (loss) 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. Decreases that offset previous



## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

increases of the same item of land are recognized in other comprehensive income. All other decreases are recognized immediately in net income (loss) 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 (loss) 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 comparable 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 each balance sheet date.

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 (loss) for the period in which the disposal occurs.

### *(h) Biological assets*

Standing timber on privately held forest land that is managed for timber production is characterized as a biological asset. Accordingly, on each balance sheet date, the biological asset is valued at its fair value less costs to sell with any change therein recognized in net income (loss) 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 removed from the forest. Land under standing timber is measured at fair value at each balance sheet date and included in property, plant and equipment.

### *(i) 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 balance sheet date.

### *(j) 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 (loss) 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 balance sheet 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.

### *(k) 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 and facility (hemlock and balsam, douglas fir and cedar);
- (ii)* Logs by end use sort (saw logs and pulp logs).

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

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, determined by actual lumber production costs divided by production volumes.

The costs for logs produced are allocated to logs based on the estimated fair value of the logs produced, except for pulp logs that are carried at market due to the significant difference between the market value of pulp logs compared to production costs.

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 with the NRV for the remaining logs based on market log prices.

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

### *(l) 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.

### *(m) 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, Non-Voting 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.

### *(n) 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 (loss) for the period over the term of the long-term debt using the effective interest method.

### *(o) 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. 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.

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

*(Tabular amounts expressed in millions of Canadian dollars)*

Past-service costs are recognized immediately in net income (loss) 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 net income (loss) for the period is charged with the Company's contribution as required under the collective agreements.

For its 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 (loss) 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 (loss) 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 share-based payment awards (i.e. 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 in 2010 and 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 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 balance sheet date and at settlement date. Any changes in the fair value of the liabilities are recognized in employee expenses in net income (loss) for the period.

## **Western Forest Products Inc.**

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### *(p) 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 balance sheet 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. 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 (loss) 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 (loss) for the period.

### *(q) 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.

### *(r) 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 (loss) for the period on a straight-line basis over 40 years, being the term of the related fibre supply contract.

### *(s) 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 (loss) for the period on a straight line basis over the period of the lease.

### *(t) 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 (loss). All finance costs are recognized in net income (loss) during the period using the effective interest method.

### *(u) 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, and held-to-maturity. 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.

Certain of the Company's investments are classified at fair value through profit and loss. These financial assets are measured at fair value at the balance sheet date with changes therein recognized in net income (loss) for the period.

## **Western Forest Products Inc.**

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

*(Tabular amounts expressed in millions of Canadian dollars)*

Loans and receivables comprise trade and other receivables. 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.

Held-to-maturity financial assets include certain investments held by the Company. 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.

Cash and cash equivalents comprise cash balances and short-term investments with original maturities of 90 days or less.

A financial asset not carried at fair value through profit or loss is assessed at each balance sheet 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 investment securities at both a specific asset and collective level. In assessing for impairment, 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.

An impairment loss is calculated as the difference between its 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 (loss) for the period and reflected in an allowance against receivables.

### *(ii) Non-derivative financial liabilities*

The Company initially recognizes debt issued on the date that it is originated. 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 recognized initially at fair value plus 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 balance sheet at fair value with changes in the (realized and unrealized) fair value being recognized as gains or losses within sales in net income (loss) for the period.

### *(v) Income tax*

Income tax expense comprises current and deferred tax. Income tax expense is recognized in net income (loss) 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 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 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 interim 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 either accounting or taxable profit or loss.

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet 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 balance sheet date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

### *(w) Earnings per share*

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

### 3. Critical Accounting Estimates and Judgements

The Company makes estimates and assumptions concerning its future operations. The resulting accounting estimates will seldom equal the related actual results. Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. In preparing these interim financial statements, the significant judgments made by management applying the Company's accounting policies and the key sources of estimation uncertainty are expected to be the same as those to be applied in the first annual IFRS financial statements.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within 2011 are included within the following notes:

Note 10 – Property, plant and equipment – measurement of the fair value of land

Note 10 – Property, plant and equipment – key assumptions used in discounted cash flows

Note 10 – Intangible assets – key assumptions used in discounted cash flows

Note 11 – Biological assets – measurement of fair value less costs to sell of standing timber

Note 16 – Employee post-retirement benefits – measurement of defined benefit obligations

Note 17 – Share capital – measurement of share-based payment transactions

Note 19 – Financial Instruments – measurement of foreign exchange forward contract derivatives

### 4. Transition to IFRS

The Company's financial statements for the year ending December 31, 2011 will be the first annual financial statements that will be prepared in accordance with IFRS. The Company's transition date is January 1, 2010 (the "transition date") and the Company has prepared its opening IFRS balance sheet at that date. The Company will prepare its opening balance sheet and financial statements for 2010 and 2011 by applying existing IFRS with an effective date of December 31, 2011 or prior. Accordingly, the opening balance sheet and financial statements for 2010 and 2011 may differ from these financial statements. The accounting policies as described in Note 2 have been applied consistently for all periods presented in these interim financial statements, including the opening IFRS balance sheet as at January 1, 2010.

#### *(a) Application of IFRS 1*

In preparing these interim financial statements in accordance with IFRS 1, the Company has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS.

Western has elected to apply the following optional exemptions in accordance with IFRS 1:

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

(i) Business combinations exemption

Western has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the January 1, 2010 transition date.

(ii) Fair value as deemed cost exemption

Western has elected to measure certain items of property, plant and equipment, primarily roads and bridges, at fair value as at January 1, 2010.

(iii) Employee benefits exemption

Western has elected to recognize all cumulative unrecognized actuarial gains and losses that existed as at January 1, 2010 in retained earnings for all its employee benefit plans.

(iv) Share-based payment transactions

Western has elected not to re-measure equity awards granted after November 7, 2002 that vested prior to the date of transition and liabilities for cash-settled awards that were settled prior to the date of transition.

(v) Arrangements containing a lease

Western has elected not to re-assess arrangements existing at the date of transition, based on the facts and circumstances at that date, in accordance with IFRIC 4.

The remaining IFRS 1 voluntary exemptions either have not or do not apply to the Company at the date of transition to IFRS on January 1, 2010.

Western has applied the following mandatory exceptions from retrospective application.

(i) Estimates exception

Estimates under IFRS at January 1, 2010 are consistent with estimates made for the same date under Canadian GAAP.

(ii) Assets held for sale and discontinued operations exception

Management has applied IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*, prospectively from January 1, 2010. Any assets held for sale or discontinued operations are recognized in accordance with IFRS 5 only from January 1, 2010. Western did not have any assets that met the held-for-sale criteria during the periods presented. No adjustment at January 1, 2010 was required.

*(b) Reconciliations between IFRS and Canadian GAAP*

In preparing its opening IFRS statement of financial position, the Company has adjusted amounts reported previously in its financial statements prepared in accordance with Canadian GAAP. An explanation of how the transition from Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

# Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

## Explanation of transition adjustments

### (i) Reconciliation of equity:

	Note	January 1, 2010			September 30, 2010		
		Canadian GAAP	Effect of transition to IFRS	IFRS	Canadian GAAP	Effect of transition to IFRS	IFRS
<b>Assets</b>							
<b>Current assets:</b>							
Cash and cash equivalents		\$ 8.1	\$ -	\$ 8.1	\$ 8.0	\$ -	\$ 8.0
Trade and other receivables		39.7	-	39.7	58.4	-	58.4
Inventory	f	105.2	-	105.2	120.2	2.1	122.3
Prepaid expenses and other assets		3.8	-	3.8	5.8	-	5.8
		<u>156.8</u>	<u>-</u>	<u>156.8</u>	<u>192.4</u>	<u>2.1</u>	<u>194.5</u>
<b>Non-current assets:</b>							
Property, plant and equipment	a,b,c,d,k	405.9	(175.9)	230.0	381.8	(172.6)	209.2
Intangible assets	a,g	-	117.5	117.5	-	115.1	115.1
Biological assets	a,e,k	-	85.7	85.7	-	80.3	80.3
Other assets		10.9	-	10.9	12.1	-	12.1
		<u>\$ 573.6</u>	<u>\$ 27.3</u>	<u>\$ 600.9</u>	<u>\$ 586.3</u>	<u>\$ 24.9</u>	<u>\$ 611.2</u>
<b>Liabilities</b>							
<b>Current liabilities:</b>							
Revolving credit facility		\$ 15.3	\$ -	\$ 15.3	\$ -	\$ -	\$ -
Accounts payable and accrued liabilities	h	55.2	(10.3)	44.9	71.3	(10.2)	61.1
Silviculture provision	h	-	10.3	10.3	-	10.4	10.4
Current portion of long-term debt		45.2	-	45.2	109.1	-	109.1
Discontinued operations		6.1	-	6.1	6.3	-	6.3
		<u>121.8</u>	<u>-</u>	<u>121.8</u>	<u>186.7</u>	<u>0.2</u>	<u>186.9</u>
<b>Non-current liabilities:</b>							
Long-term debt		74.5	-	74.5	-	-	-
Silviculture provision	h	-	15.7	15.7	-	15.7	15.7
Other liabilities	h,i	29.8	(14.2)	15.6	29.6	0.2	29.8
Deferred revenue		72.4	-	72.4	70.9	-	70.9
		<u>298.5</u>	<u>1.5</u>	<u>300.0</u>	<u>287.2</u>	<u>16.1</u>	<u>303.3</u>
<b>Shareholders' equity:</b>							
Share capital		599.8	-	599.8	599.8	-	599.8
Contributed surplus	j	2.5	0.2	2.7	2.8	0.1	2.9
Revaluation reserve	b	-	23.9	23.9	-	23.9	23.9
Deficit		(327.2)	1.7	(325.5)	(303.5)	(15.2)	(318.7)
		<u>275.1</u>	<u>25.8</u>	<u>300.9</u>	<u>299.1</u>	<u>8.8</u>	<u>307.9</u>
		<u>\$ 573.6</u>	<u>\$ 27.3</u>	<u>\$ 600.9</u>	<u>\$ 586.3</u>	<u>\$ 24.9</u>	<u>\$ 611.2</u>



## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### (ii) Reconciliation of comprehensive income for the periods:

(Expressed in millions of Canadian dollars) (Unaudited)	Three months ended September 30, 2010			Nine months ended September 30, 2010			
	Note	Canadian	Effect of	Canadian	Effect of	IFRS	
		GAAP	transition to IFRS	IFRS	GAAP	transition to IFRS	IFRS
Revenue		\$ 175.5	\$ -	\$ 175.5	\$ 495.3	\$ -	\$ 495.3
Cost and expenses:							
Cost of goods sold							
Cost of sales	h,e,f	141.6	(0.6)	141.0	388.0	(1.7)	386.3
Amortization	d,g	6.7	(1.3)	5.4	22.2	(4.0)	18.2
		148.3	(1.9)	146.4	410.2	(5.7)	404.5
Export tax		1.0	-	1.0	2.9	-	2.9
Freight		15.4	-	15.4	46.9	-	46.9
Selling and administration	i	5.8	-	5.8	16.9	0.1	17.0
		170.5	(1.9)	168.6	476.9	(5.6)	471.3
		5.0	1.9	6.9	18.4	5.6	24.0
Operating restructuring items		(0.6)	-	(0.6)	(1.5)	-	(1.5)
Other income (expenses)	k	6.3	(6.6)	(0.3)	18.4	(8.0)	10.4
<b>Operating income (loss)</b>		10.7	(4.7)	6.0	35.3	(2.4)	32.9
Finance costs	h	(3.4)	(0.1)	(3.5)	(9.8)	(0.3)	(10.1)
Net income (loss) before income taxes		7.3	(4.8)	2.5	25.5	(2.7)	22.8
Income tax expense		(0.1)	-	(0.1)	(0.6)	-	(0.6)
Net income from continuing operations		7.2	(4.8)	2.4	24.9	(2.7)	22.2
Net loss from discontinued operations		(0.3)	-	(0.3)	(1.2)	-	(1.2)
<b>Net income (loss) for the period</b>		6.9	(4.8)	2.1	23.7	(2.7)	21.0
<b>Other comprehensive income (loss)</b>							
Defined benefit plan actuarial gains (losses), net of taxes	i	-	1.5	1.5	-	(14.2)	(14.2)
<b>Total comprehensive income (loss) for the period</b>		\$ 6.9	\$ (3.3)	\$ 3.6	\$ 23.7	\$ (16.9)	\$ 6.8

### (iii) Reconciliation of Property, Plant and Equipment

	January 1, 2010	
Property, plant and equipment, Canadian GAAP	\$	405.9
Biological and intangible assets - reclassification	a	(184.9)
Land - fair value	b	23.9
Logging roads - deemed cost	c	0.9
Buildings & equipment - deemed cost	c	0.7
Buildings & equipment - impairment	d	(16.5)
Property, plant and equipment, IFRS	\$	230.0

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### (iv) Material adjustments to the Statements of Cash Flows

None of the Company's IFRS transitional adjustments directly impact the cash and cash equivalents balance and result only in adjustments within the cash flow presentation itself. The adjustments required to the Statement of Cash Flows under IFRS arise due to relatively minor income adjustments, primarily a reduction to amortization, which resulted in a corresponding non-cash add-back adjustment. There are no other material differences between the Statement of Cash Flows presented under IFRS and the Statement of Cash Flows presented under Canadian GAAP.

Notes:

- a. Under IFRS, the "Property, plant and equipment" line item was reduced by \$16.2 million, as at January 1, 2010, as a result of re-classifying the Company's standing timber on its private timberlands, which is considered to be a biological asset under IFRS, to a separate line item, titled "Biological assets" (Note e). In addition, the Canadian GAAP net book value of crown timber tenures of \$168.7 million as at January 1, 2010 was re-classified from the "Property, plant and equipment" line item to a separate line item, titled "Intangible assets" (Note g).
- b. "Property, plant and equipment" was also impacted by the Company's policy choice of electing to use the revaluation model to fair value its land assets both at transition date and prospectively at each balance sheet date under IFRS, as compared to a historical cost basis of measurement under Canadian GAAP. As at January 1, 2010, the increase that resulted from this election was \$23.9 million with a corresponding credit to the revaluation reserve, a component of accumulated other comprehensive income and shareholders' equity.
- c. Western adopted the transitional optional exemption of valuing certain items of its "Property, plant and equipment", primarily roads and bridges, at fair value at transition date, which is then considered to be the deemed cost of those assets prospectively. The net impact of this was an increase to the Canadian GAAP net book value of these assets by \$1.6 million, as at January 1, 2010.
- d. As a result of applying guidance in IAS 36, the Company's sawmill buildings and equipment, which are categorized within "Property, plant and equipment", recognized an impairment loss on transition date of \$16.5 million. Under Canadian GAAP, the recoverable amount of these assets was calculated on an undiscounted basis. Under IFRSs, the recoverable amount of the CGU was estimated based on its value in use, which requires estimated future cash flows to be discounted. The key assumptions used in this value in use assessment are discussed in Note 10 to the March 31, 2011 interim financial statements. Depreciation expense associated with sawmill buildings and equipment under IFRS was reduced by \$2.8 million when compared to that recognized under Canadian GAAP, for the nine months ended September 30, 2010 as a result of the reduced net book value of sawmill buildings and equipment as at January 1 2010.
- e. This adjustment reflects the separation of the Company's standing timber on its private timberlands, which is considered to be a biological asset under IFRS, which was previously included in the line item "Property, plant and equipment" under Canadian GAAP. The net book value of the standing timber reported under Canadian GAAP of \$16.2 million, which was measured at historical cost, was reclassified into "Biological assets", and was subsequently valued at fair value less costs to sell of \$85.7 million on transition to IFRS. The increase of \$69.5 million was credited to "Deficit" in shareholders' equity as at January 1, 2010. The key assumptions used in this valuation are discussed in Note 11 to the March 31, 2011 interim financial statements. The adjustments to "Biological assets" as at September 30, 2010 reflect this initial adjustment on transition plus the effects of any asset sales and any further adjustments to the fair value less costs to sell including those resulting from timber growth and harvest over the nine month period. These changes to fair value less costs to sell for the Company's biological assets of \$0.6 million (expense) for the nine months ended September 30, 2010 have been reflected in "cost of sales" in net income (loss) for the period (three months ended September 30, 2010 - \$0.6 million (income)).
- f. As a result of the Company's standing timber on private timberlands being considered a biological asset in accordance with IAS 41, *Agriculture*, the logs harvested from these private timberlands are considered to be agriculture produce that are measured at fair value less costs to sell at the point of harvest, which becomes the deemed cost for the purpose of subsequent accounting under IAS 2, *Inventories*. As a result, an adjustment was required to be made to log and lumber inventory values

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

as reported under Canadian GAAP at September 30, 2010 of \$2.1 million, to reflect this guidance under IAS 41 for logs in inventory and harvested from private timberlands.

- g. The adjustment to "Intangible assets" of \$117.5 million on transition reflects the re-classification of the Canadian GAAP net book value for the Company's crown timber tenures from "Property, plant and equipment" of \$168.7 million to "Intangible assets", combined with an impairment charge on transition date as a result of applying IAS 36 *Impairments*, of \$51.2 million. Under Canadian GAAP, the recoverable amount of these assets was calculated on an undiscounted basis. Under IFRSs, the recoverable amount of the CGU was estimated based on its value in use, which requires estimated future cash flows to be discounted. The key assumptions used in this value in use assessment are discussed in Note 10 to the March 31, 2011 interim financial statements. Amortization expense associated with the crown timber tenures under IFRS was reduced by \$1.2 million when compared to that recognized under Canadian GAAP, for the nine months ended September 30, 2010, as a result of the reduced net book value of crown timber tenures as at January 1 2010 (three months ended September 30, 2010 - \$0.4 million reduction).
- h. Under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, there are measurement differences when compared to Canadian GAAP. For the Company's silviculture provision, these measurement differences under IFRS relate to the cash flows being discounted using a risk free rate rather than the Company's credit adjusted risk free rate as prescribed under Canadian GAAP. As a result of this measurement difference, the short term and long term components of the silviculture provision were increased by \$0.1 million and \$1.3 million, respectively, with a corresponding charge to the "Deficit" line in shareholders' equity as at January 1, 2010. In addition, the silviculture provision has been separately disclosed on the Statement of Financial Position on transition to IFRS, which resulted in \$10.2 million and \$14.4 million reduction in "Accounts payable and accrued liabilities" and "Other liabilities", respectively, as a result of this re-classification, when compared to Canadian GAAP. On the Statements of Comprehensive Income, the unwinding of the discount associated with the silviculture provision under IFRS of \$0.3 million for the nine months ended September 30, 2010 has been recognized within finance costs rather than within cost of goods sold as under Canadian GAAP (three months ended September 30, 2010 - \$0.1 million).
- i. An adjustment was made to "Other liabilities" to account for the different methodologies under IFRS compared to Canadian GAAP for calculating the liability associated with employee post retirement benefits. Under IFRS, the Company's accounting policy is to recognize all actuarial gains and losses in other comprehensive income. Under Canadian GAAP, the Company's accounting policy was such that the excess of the net accumulated actuarial gain or loss over 10% of the greater of the accrued benefit obligation and the fair value of plan assets was amortized over the remaining service period of the active employees. In addition, the Company has elected that at the date of transition all previously unrecognized cumulative actuarial gains and losses were recognized in retained earnings. This change required an additional liability to be recognized on transition date of \$0.2 million with a corresponding charge to the "Deficit" line in shareholders' equity. Similar recalculations were made in the nine months ended September 30, 2010 resulting in additional adjustments to the employee post retirement benefits obligation of \$14.2 million (three months ended September 30, 2010 - \$1.5 million). These adjustments are reflected on the Statements of Comprehensive Income in line item "Other comprehensive income."
- j. Under Canadian GAAP, Western recognized the fair value of the share-based payment awards, determined at the time of the grant, on a straight-line basis over the five-year vesting period. Under IFRS 2, *Share-Based Payments*, the fair value of each tranche of the award is considered to be a separate grant based on the vesting period, with the fair value of each tranche determined separately and recognized as compensation expense over the term of its respective vesting period. An adjustment was made to "Contributed surplus" to account for the different calculations to be applied under IFRS compared to Canadian GAAP for calculating the cost of share-based payment awards. This change required an increase to "Contributed surplus" to be recognized on transition date of \$0.2 million with a corresponding charge to the "Deficit" line in shareholders' equity.
- k. The adjustment to "Other income (expenses)" of \$8.0 million for the nine months ended September 30, 2010 (three months ended September 30, 2010 - \$6.6 million) relates to the differences between the calculated gains or losses on asset sales under IFRS when compared to Canadian GAAP. These differences result from fair value adjustments to the Canadian GAAP net book values for land,

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

biological assets and certain items of property, plant and equipment as a result of Management's accounting policy elections or requirements under IFRS as outlined under Notes b., c. and e. above.

### 5. Seasonality of Operations

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

### 6. Segmented Information

The Company is an integrated Canadian forest products business operating in one industry segment comprised of timber harvesting and lumber production for marketing and distribution to worldwide markets.

### 7. Discontinued Operations

In March 2006, the Company closed its Squamish pulp mill located on 213 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 and while site remediation is ongoing, the Company has listed the property for sale.

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Net loss from discontinued operations	\$ (0.3)	\$ (0.3)	\$ (0.8)	\$ (1.2)
Cash used in discontinued operations	\$ (0.3)	\$ (0.3)	\$ (0.8)	\$ (1.2)
			September 30, 2011	December 31, 2010
Assets of discontinued operations			\$ 2.3	\$ 2.3
Liabilities of discontinued operations			\$ 6.2	\$ 6.2

The assets of discontinued operations are included in "Other assets" on the Statement of Financial Position.

### 8. Related Parties

Brookfield Special Situations Management Limited ("BSSML") controls and directs 49% of the Company's Common Shares and 100% of the Non-Voting Shares. BSSML is a wholly owned subsidiary of Brookfield Asset Management ("BAM").

In addition to the related party transactions identified elsewhere in these interim 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 for the three and nine months ended September 30:

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

	Three months ended		Nine months ended	
	September 30		September 30	
	2011	2010	2011	2010
Costs incurred for:				
Log purchases	\$ 4.2	\$ 2.0	\$ 8.7	\$ 5.9
Other	1.2	1.2	3.4	3.7
	<u>\$ 5.4</u>	<u>\$ 3.2</u>	<u>\$ 12.1</u>	<u>\$ 9.6</u>
Income received for:				
Log sales	\$ 2.6	\$ 0.6	\$ 4.6	\$ 2.8
Other (see comment below)	-	-	2.4	9.4
	<u>\$ 2.6</u>	<u>\$ 0.6</u>	<u>\$ 7.0</u>	<u>\$ 12.2</u>

In October 2009, the Company sold certain higher-and-better-use properties in central and northern Vancouver Island (the "HBU Properties") to WFP Forest Products Ltd, ("WFPFPL"), a jointly-owned entity of the Company and Brookfield Properties Limited ("BPL"), a wholly-owned subsidiary of Brookfield Properties Corporation (TSX: BPO.TO), which is in turn related to BAM. The HBU Properties were formerly part of the group of properties that were included in the Company's non-core asset sales program. In connection with the reorganization of WFPFPL as a jointly-owned entity and the sale of those HBU Properties, Western received cash proceeds of \$12.4 million, \$3.0 million in October 2009 and the balance of \$9.4 million on January 4, 2010. As part of the arrangements, WFPFPL had a right of first offer to purchase for possible future development approximately 255 hectares (630 acres) of additional higher-and-better-use properties of the Company in central and northern Vancouver Island. These properties also represent non-core assets of the Company. Western held less than 5% of the equity of WFPFPL and had a right to sell its interest in WFPFPL to BPL for its fair market value at any time on or after January 1, 2011. On January 4, 2011, the Company exercised the option to sell its equity interest in WFPFPL. Western received \$2.4 million as consideration for the sale of its interest, and the right of first offer was extinguished. Brookfield is the manager of WFPFPL, which also holds Carma Developers LP, a limited partnership that carries on a land development business across Western Canada. Because BPL is a related party of BSSML, which is Western's largest shareholder, the transactions constitute related party transactions.

### 9. Inventory

The following table summarizes the value of inventory on hand:

	September 30, 2011	December 31, 2010
Logs	\$ 88.1	\$ 80.4
Lumber	47.9	43.0
Supplies and other inventories	11.1	10.7
Provision for write downs	(4.0)	(4.5)
Total value of inventories	<u>\$ 143.1</u>	<u>\$ 129.6</u>
Inventory carried at net realisable value	\$ 17.2	\$ 23.7

The inventory is pledged as security against the revolving credit line. During the third quarter of 2011, \$190.1 million (2010 - \$146.4 million) of inventory was charged to cost of sales which included a reduction in the provision for write-down to net realizable value of \$0.6 million (2010 – an increase of \$0.5 million).

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### 10. Property, Plant, and Equipment and Intangible Assets

#### Capital Assets Continuity

	Buildings & equipment	Logging roads	Land	Total property, plant and equipment	Intangible assets
<b>at January 1, 2010</b>					
Cost of capital assets at December 31, 2009	\$ 144.1	\$ 107.6	\$ 108.2	\$ 359.9	\$ 190.4
Accumulated amortization and impairment at December 31, 2009	(71.9)	(67.0)	-	(138.9)	(21.7)
Adjustments on transition to IFRS	(15.8)	0.9	23.9	9.0	(51.2)
Net book value at January 1, 2010	56.4	41.5	132.1	230.0	117.5
<b>at September 30, 2010</b>					
Net book value at January 1, 2010	56.4	41.5	132.1	230.0	117.5
Additions	2.1	6.1	-	8.2	-
Disposals	-	(0.7)	(12.4)	(13.1)	-
Amortization	(7.8)	(8.1)	-	(15.9)	(2.4)
Net book value at September 30, 2010	\$ 50.7	\$ 38.8	\$ 119.7	\$ 209.2	\$ 115.1
<b>at December 31, 2010</b>					
Cost of capital assets at December 31, 2010	\$ 117.8	\$ 110.7	\$ 119.0	\$ 347.5	\$ 190.4
Accumulated amortization and impairment at December 31, 2010	(69.4)	(72.7)	-	(142.1)	(57.6)
Net book value at December 31, 2010	48.4	38.0	119.0	205.4	132.8
<b>at September 30, 2011</b>					
Net book value at December 31, 2010	48.4	38.0	119.0	205.4	132.8
Additions	6.2	6.7	-	12.9	-
Disposals	(0.3)	(3.6)	(8.1)	(12.0)	(1.7)
Amortization	(8.1)	(7.5)	-	(15.6)	(2.7)
Impairments	-	-	-	-	(1.3)
Net book value at September 30, 2011	\$ 46.2	\$ 33.6	\$ 110.9	\$ 190.7	\$ 127.1

As a result of the fair value assessment of the land holdings at September 30, 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:

	September 30, 2011	December 31, 2010	September 30, 2010
Cost	\$81.6	\$98.3	\$99.5

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### 11. Biological Assets

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Carrying value at beginning of period	\$ 61.0	\$ 84.5	\$ 77.7	\$ 85.7
Disposition of standing timber in the period	-	(4.8)	(15.7)	(4.8)
Change in fair value resulting from growth and pricing	0.6	0.8	1.5	2.4
Harvested timber transferred to inventory during the period	(1.3)	(0.2)	(3.2)	(3.0)
Carrying value at end of period	\$ 60.3	\$ 80.3	\$ 60.3	\$ 80.3

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 balance sheet date, and the underlying land considered a component of property, plant and equipment, which the Company has elected to record at fair value at each balance sheet date (Note 10).

At September 30, 2011 standing timber comprised approximately 25,484 hectares (December 31, 2010 - 33,780 hectares), which range from newly planted cut-blocks to old-growth forests. During the third quarter of 2011 the Company harvested and scaled approximately 76,515m<sup>3</sup> of logs from its private timberlands, which had a fair value less costs to sell of \$5.5 million at the date of harvest (three months ended September 30, 2010: 41,368m<sup>3</sup> - \$2.7 million).

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.

The disposition reflected in the first quarter of 2011 primarily relates to the sale of properties to TimberWest Forest Corp. as detailed in Note 21. The disposition reflected in the third quarter of 2010 related to the sale of properties to the Capital Regional District of Victoria, British Columbia.

### 12. Revolving Credit Facility

The Company's revolving credit facility, as amended on December 14, 2010, 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 revolving credit facility matures on December 14, 2015 subject to any future refinancing requirements of its revolving and non-revolving term loans. At September 30, 2011 \$8.2 million was drawn on the facility (December 31, 2010 - nil). At September 30, 2011, \$96.7 million of the facility was available to the Company. The interest rate for the revolving credit facility was 3.50% at September 30, 2011 (December 31, 2010 - 3.75%).

### 13. Long-Term Debt

In the first quarter of 2011, the non-revolving term loan of \$31.2 million was fully repaid, largely from the proceeds of non-core asset sales. In the second and third quarters of 2011, \$12.6 million and \$3.3 million, respectively, was repaid on the \$75.0 million revolving term loan. At September 30, 2011, the \$15.9 million repaid during the second and third quarters was still available to the Company. The revolving term loan matures on June 14, 2013.

The term loans bear interest at an index rate, determined as the higher of (i) the Canadian prime rate, and (ii) the 30 day Bankers Acceptance rate plus 1.35%, plus the applicable index rate margin, or at the Company's election, the applicable Bankers Acceptance rate, plus the applicable BA rate margin. The applicable index rate margins range from 2.75% to 5.00% and the applicable BA rate margins range from 3.75% to 6.00% and each is determined quarterly, based on a leverage ratio, calculated as the ratio of total debt to the sum of EBITDA for the twelve months ending on the date of determination.

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

The interest rate for the revolving term loan was 5.75% at September 30, 2011 (December 31, 2010 – 6.03%).

The Company was in compliance with its financial covenants at September 30, 2011.

During 2010, the Company incurred \$1.3 million of transaction costs in relation to the new financing arrangements. These costs are deferred and are being amortized into interest expense over the term of the term loans using the effective interest rate method. Deferred transaction costs associated with the previous facilities were fully expensed during 2010.

	September 30, 2011	December 31, 2010
Canadian dollar debt		
Revolving term loan	\$ 59.1	\$ 75.0
Non-revolving term loan	-	31.2
	<u>59.1</u>	<u>106.2</u>
Less transaction costs	(0.7)	(1.3)
	<u>\$ 58.4</u>	<u>\$ 104.9</u>

### 14. Silviculture Provision

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

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Silviculture provision, beginning of period	\$ 29.4	\$ 28.4	\$ 27.3	\$ 26.0
Silviculture provision charged	4.1	2.3	10.6	7.9
Silviculture work payments	(4.3)	(4.7)	(8.5)	(8.1)
Disposition of intangible assets	-	-	(0.4)	-
Unwind of discount	0.1	0.1	0.3	0.3
Silviculture provision, end of period	<u>29.3</u>	<u>26.1</u>	<u>29.3</u>	<u>26.1</u>
Less current portion	11.5	10.4	11.5	10.4
	<u>\$ 17.8</u>	<u>\$ 15.7</u>	<u>\$ 17.8</u>	<u>\$ 15.7</u>

### 15. Other Liabilities

	September 30, 2011	December 31, 2010
Employee post-retirement benefits obligation <sup>(Note 16)</sup>	\$ 34.7	\$ 21.1
Environmental accruals	1.5	1.5
Other	1.6	0.7
	<u>\$ 37.8</u>	<u>\$ 23.3</u>



## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### 16. Employee Post-Retirement Benefits

Employee post-retirement benefit expense for both the defined benefit salaried pension and non-pension plans recognized in cost of goods sold is as follows:

	Three months ended September 30		Nine months ended September 30	
	2011	2010	2011	2010
Current service costs	\$ 0.1	\$ 0.4	\$ 0.3	\$ 1.2
Interest costs	1.6	1.7	4.8	5.1
Expected return on plan assets	(1.6)	(1.6)	(4.8)	(4.8)
Cost of defined benefit plans	0.1	0.5	0.3	1.5
Cost of defined contribution plans	2.4	1.7	7.0	5.5
Total cost of employee post-retirement benefits	\$ 2.5	\$ 2.2	\$ 7.3	\$ 7.0

The amounts recognized in the Statement of Financial Position for the Company's employee post-retirement benefit obligations, consisting of both the defined benefit salaried pension and other non-pension benefits are as follows:

	September 30, 2011	December 31, 2010
Present value of funded obligations	\$ (129.6)	\$ (123.2)
Fair value of plan assets	94.9	102.1
Liability recognized in the balance sheet	\$ (34.7)	\$ (21.1)

The change in the liability recognized in the Statement of Financial Position at September 30, 2011 was based on the actuarial gains or losses resulting from estimated changes in the discount rate used to value the defined benefit obligations and estimated differences in actual compared to expected returns on plan assets for the quarter. The change in discount rates in the third quarter of 2011 was a decrease of 0.6% from the rate used at June 30, 2011 of 5.4%, and the estimated actual return on assets in the quarter was a loss of 16.4% which was based on the index returns for the target asset mix of the related plans.

### 17. Share Capital

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

	Number of Common Shares	Amount	Number of Non-Voting shares	Amount
Balance at September 30, 2011 and December 31, 2010	128,625,623	\$412.3	338,945,860	\$187.5

#### *Share-based payment transactions*

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.

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 Toronto Stock Exchange ("TSX") on the day immediately preceding the grant date. Options granted under the Option Plan expire a maximum of ten years from the date of the grant.

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

In the first quarter of 2011, the Company granted 1,700,000 options with a fair value of \$0.7 million as determined by the Hull-White option pricing model using the assumptions of a weighted average exercise price \$0.75, risk free interest rates within a range of 2.89% to 3.32%, volatility rates of between 59.7% to 67.1% and an expected life of between 6 and 10 years. These options are only exercisable when the share price exceeds \$0.70 for 60 consecutive days on a volume weighted average price basis. All options outstanding that were granted prior to 2010 do not contain the minimum price requirement and continue to be valued under the Black-Scholes model.

At September 30, 2011 6,441,795 options were outstanding under the Company's Option Plan with a weighted average exercise price of \$0.70 per Common Share. During the nine months ended September 30, 2011 the Company recorded compensation expense of \$0.3 million (2010 - \$0.2 million).

The Company also has a Deferred Share Unit 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. 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 the first quarter of 2011 designated executive officers were allotted 201,300 DSUs at a price of \$0.77 per DSU and a further 4,953 DSUs were issued to a director at a price of \$1.06 per DSU. During the second and third quarters of 2011 a further 7,012 DSUs and 7,422 DSUs were issued to a director at a price of \$0.82 and \$0.64 per DSU, respectively. The cumulative number of DSUs outstanding at September 30, 2011 was 817,643 (December 31, 2010 – 596,956). During the third quarter of 2011, the Company recorded compensation recovery for these DSUs of \$0.1 million (2010 - nil), with a corresponding reduction to accounts payable and accrued liabilities.

### 18. Commitments and Contingencies

#### *(a) Long-term fibre supply agreements*

Certain of the Company's long term fibre supply agreements with third parties have minimum volume requirements and may, in the case of a failure to produce the minimum 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.

During the three months ended September 30, 2011 the Company amended one of its long-term fibre supply agreements including the modification of minimum chip volume commitments such that a shortfall that existed for the 2010 annual commitments was eliminated. Consequently, Western has no remaining 2010 chip volume commitment shortfalls associated with its long term fibre supply agreements.

Based on chip and pulp log volumes supplied year-to-date, the Company anticipates satisfying annual fibre commitments for 2011.

#### *(b) Storm damage*

In late September 2010, heavy rains and strong winds on the northwest of Vancouver Island triggered power outages, mudslides, road washouts and flooding. Certain logging areas were impacted by these severe storms with bridge and culvert damage, logging road washouts and slides in reforested areas. An insurance claim of \$1.8 million has been accepted by Western's insurers and an amount of \$0.8 million was received, net of the deductible of \$1.0 million, and recorded in the third quarter of 2011. Work to repair the damages is in progress with the majority of the work having been completed by the end of the current quarter.

#### *(c) Lumber duties*

On January 18, 2011 the United States initiated an arbitration with Canada under the Softwood Lumber Agreement ("SLA") over its concern that the province of British Columbia ("BC") 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 United States filed a detailed

## **Western Forest Products Inc.**

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

*(Tabular amounts expressed in millions of Canadian dollars)*

statement of claim with the arbitration panel. Canada is expected to deliver its initial response to the United States claim in November 2011. A hearing before the arbitration panel is expected to take place in February 2012 with a final decision expected in the second half of 2012.

It is not possible to predict the outcome of the claims, or whether they would potentially have any impact on Western since they are specifically directed at practices in the interior of British Columbia, and Western operates predominantly on the coast of British Columbia.

### **19. Financial Instruments**

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 mitigate this foreign exchange risk, the Company entered into an agreement dated March 31, 2009 with BAM to provide a foreign exchange facility ("Facility") to the Company. The Facility provides for a notional amount of up to US \$80.0 million, matures on March 31, 2012, and allows for forward transactions with a maximum term for each transaction of one year. The Facility automatically extends for one year on each anniversary date, provided that BAM has not notified the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and subject to certain change of control provisions. The Facility is unsecured and is subject to an annual fee of 0.10% of the maximum notional amount. The Company does not consider the counter party credit risk associated with this Facility to be significant.

As at September 30, 2011, the Company had outstanding obligations to sell an aggregate JPY 5,550 million at an average rate of JPY 79.28 per CAD with maturities through September 30, 2012, and an aggregate US \$29.6 million at an average rate of US \$1.0215 per CAD with maturities through December 31, 2012. All foreign currency gains or losses to September 30, 2011 have been recognized in revenue in net income (loss) for the period and the fair value of these instruments at September 30, 2011 was a net liability of \$5.8 million (December 31, 2010 – net asset of \$0.8 million) which is included in accounts payable and accrued liabilities on the Statement of Financial Position. A net gain of \$1.0 million was recognized on contracts which were settled in the nine months ended September 30, 2011 (2010 – net loss of \$0.7 million), which was included in revenue in net income (loss) for the period.

### **20. Operating Restructuring Items**

Operating restructuring costs of \$0.9 million in the nine months ended September 30, 2011 relate to severance costs associated primarily with restructuring administrative functions.

### **21. Other Income (Expenses)**

Other expenses of \$1.9 million in the third quarter of 2011 relate primarily to an impairment loss taken on intangible and other assets (Note 24).

The first quarter of 2011 included net losses on non-core asset sales of \$0.8 million, a gain on the sale of an equity interest in certain real estate properties of \$2.4 million (Note 8), an expense incurred of \$2.5 million to secure amendments to the terms of certain contractual arrangements, and other items totaling income of \$0.4 million. The most significant non-core asset sale in the first quarter was the previously announced sale to TimberWest Forest Corp. of 7,678 hectares of land and biological assets located in the southern portion of Vancouver Island near Jordan River for gross proceeds of \$21.9 million. In addition, during the first quarter the Company exercised the option to sell its equity interest in WFPFPL, the jointly owned entity established in 2009 between the Company and BPL, receiving \$2.4 million as consideration for the sale of its interest, and the right of first offer was extinguished (Note 8). The expense recognized in the first quarter of 2011 of \$2.5 million relating to the securing of amendments to certain existing contractual arrangements is payable in 14 equal quarterly installments commencing March 31, 2011.

The first quarter of 2010 included other income of \$10.4 million. This amount primarily related to a receipt in January 2010 of \$8.9 million being the balance of the proceeds related to the establishment of the jointly-owned entity in 2009 with BPL, a company related to BAM (Note 8). Also included in other income was a re-imburement from the Province of British Columbia of \$0.9 million relating to prior-period stumpage re-assessments, and sundry other items totaling \$0.6 million.

## Western Forest Products Inc.

2011 Third Quarter Report

Notes to the Unaudited Condensed Consolidated Interim Financial Statements

(Tabular amounts expressed in millions of Canadian dollars)

### 22. Expenses by Function

	Three months ended September 30		Three months ended September 30	
	2011	2010	2011	2010
Administration	\$ 4.0	\$ 3.3	\$ 12.4	\$ 9.7
Distribution expenses	27.9	18.9	81.3	57.1
Cost of goods sold	190.1	146.4	511.1	404.5
	<u>\$ 222.0</u>	<u>\$ 168.6</u>	<u>\$ 604.8</u>	<u>\$ 471.3</u>

### 23. Other Expense Information

The Company recorded total employee compensation costs for the nine months ended September 30, 2011 of \$138.4 million (2010 - \$117.4 million). Total amortization expense for the nine months ended September 30, 2011 was \$18.3 million (2010 - \$18.3 million).

### 24. Subsequent Event

On October 11, 2011, Western announced it had reached an agreement to sell Tree Farm Licence 60 and related assets on Haida Gwaii to Taan Forest Limited Partnership, 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, Western will receive net proceeds of approximately \$11.6 million and certain ongoing rights to cedar logs harvested by Taan. Taan will assume substantially all of the obligations of Western on Haida Gwaii. The sale is expected to be completed before the end of the year and so the transaction will be recognized in the fourth quarter, but an impairment of \$1.7 million has been recognized on the net assets in the current quarter.



**Western Forest Products Inc.**

Suite 510  
700 West Georgia Street  
T D Tower, PO Box 10032  
Vancouver, British Columbia  
Canada V7Y 1A1  
Telephone: 604 665 6200

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

Trading on the TSX as “WFP”