



Western Forest Products Inc.
2010 Annual Report

Financial Highlights

<i>(millions of dollars except where noted)</i>	Year ended December 31,		
	2010	2009	2008
Sales	\$ 667.9	\$ 580.5	\$ 814.8
Net income (loss) and comprehensive income (loss)	\$ 27.7	\$ (75.3)	\$ (85.6)
Cash flow from continuing operations	\$ 28.5	\$ 63.2	\$ (50.7)
Weighted average common and non-voting shares outstanding ('000)	467,571	452,431	204,414
Basic and diluted net income (loss) per share (dollars)	\$ 0.06	\$ (0.17)	\$ (0.42)
EBITDA ⁽¹⁾	\$ 47.7	\$ (34.8)	\$ (42.4)
Working capital	\$ 118.3	\$ 37.4	\$ 44.6
Total assets	\$ 587.1	\$ 576.0	\$ 726.0
Net debt ⁽²⁾	\$ 99.8	\$ 126.9	\$ 233.0
Net debt to capitalization ⁽³⁾	0.25	0.31	0.43
Total liquidity ⁽⁴⁾	\$ 84.6	\$ 37.3	\$ 22.3

⁽¹⁾ Non-GAAP measure - see page 4 for discussion on EBITDA.

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

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

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

Letter to Shareholders

Dear Shareholders,

2010 was a significant year for Western, marking a step change in the financial performance of the Company and its outlook. Western generated its first year of positive earnings since 2006, improved its safety performance record, and took significant initiatives to position itself for the future. The improved performance is largely due to reorganization within the business, moderately improved market conditions, and higher utilization of the Company's financial and operational assets.

2010 A Positive Year

Western has worked hard over the last two years to reduce fibre and sawmill conversion costs, increase utilization of our operational assets, and increase by-product revenues. Our entire workforce has been instrumental in these initiatives and is engaged in our drive for continuous improvement. The result of all of this effort shows in our financial results which were vastly improved from a year ago:

- increase in net income of \$103 million
- EBITDA of \$48 million is an \$83 million increase over 2009
- free cash flow of \$24 million represents a \$79 million improvement from 2009.
- liquidity finished at \$85 million, compared to \$37 million at the end of 2009

Liquidity preservation was a key management focus item, resulting in a measured alignment between market demand and our production, in order to maintain inventories at their lowest market effective levels.

Three Western sawmills, Somass, Ladysmith and Nanaimo, which were idle in 2009, were safely restarted in 2010, increasing our operating capacity by 20%. Their start-ups are a result of improvement in worldwide lumber demand, particularly in China. Additionally, we negotiated new long-term contracts with our two major union partners throughout our operations.

The improved financials did not come at the expense of our safety program. In fact, our twelve month rolling average medical incident rate (the number of incidents per 100 employees per year) improved to a historical low of 1.7 from 3.4 in 2009. We also achieved third party safety certification in both our timberland and manufacturing operations. The safety of our employees remains one of our core values and we will continue to work our systems and processes to actively ensure all of our employees get home safely each day.

The progress that we made in 2010 was clearly demonstrated by the increase in our share price. Our share price opened the year at \$0.20 and finished the year at \$0.80, an increase of 300%. This increase represents one of the most significant improvements in the forest products sector. We believe our share price is still under valued.

Promising Outlook

The unique attributes of the diverse coastal fibre basket continue to provide Western with the opportunity to participate in lumber markets around the world. We have the manufacturing, worldwide marketing, and distribution infrastructure along with the critical mass to successfully utilize our 7.2 million cubic metres of annual allowable cut. In 2010, close to 60% of our production was sold outside of North America.

We continue to be cautious about the prospects for 2011. We believe that both lumber and log demand will be slightly improved from 2010, largely driven by increased demand in Asia. It is our expectation that a recovery in selling prices back to trend levels will not occur until at least 2012.

In 2010 we continued to participate in the rapid growth of China as a log and lumber destination and 2011 shows no signs of that growth slowing. While the demand for wood products in China has been

primarily generated by concrete forming needs, new approvals for wood home construction resulting from the rapid growth in urbanization are expected to increase demand for higher value wood products. From a volume perspective, we expect China to be our largest market in 2011.

Japan began its recovery from the impact of the economic crisis; housing starts in Japan were up 3% in 2010, however our sales into this high value market grew by 27%. Forecasters are expecting this trend in housing to continue.

Niche markets, such as Australia and Europe, stabilized in 2010. These markets remain good consumers of the higher quality component of our fibre basket. As their economies improve we expect to see increased sales volumes in 2011.

The housing market in North America is improving, but we believe that it will take several more years before it returns. With the high unemployment and significant foreclosure rates, 2011 housing starts in the United States are not expected to improve much from 2010 levels. For the commodity segment of our business we are prepared to re-enter the US market when price levels become competitive with other world market levels.

Improved Balance Sheet

Through the year the Company continued to improve its balance sheet by shedding a number of non-core assets, using the proceeds to pay down our long term debt. Net debt was reduced by \$27 million during the year, decreasing our total net debt to \$100 million by the end of the year. As a result, our net debt to capitalization ratio improved to 25%, our lowest ratio ever. The recent sale of our southern private timberlands will further reduce our debt on a pro forma basis to 20%.

Our balance sheet is solid. With the strengthening of our balance sheet, we are now implementing our strategic plans, which were put on hold by the severe global recession. I believe the worst is over. It is with renewed vigour that we will carry out these plans, knowing that our financial house is in order.

To further prepare ourselves for the inevitable increase in demand, we are embarking on a three to four year \$200 million investment program. Of the \$200 million, \$125 million will be strategic re-investment to increase kiln capacity, further develop small log capacity, and reduce operating costs. The timing of such investments will be determined by the pace of recovery of our markets and security of our fibre supply.

The strategic and sustaining capital projects will be funded from operating cash flow, leaving headroom on our balance sheet for further investment opportunities. Our investment program demonstrates our commitment to cementing our position as the forest product leader on the coast of British Columbia.

In short, we are well positioned, and well capitalized to participate in the market recovery.

On behalf of Western, we would like to thank our shareholders for their continued support, and our employees, contractors, suppliers and communities for their patience and dedication in building a successful coastal forest products business.



Dominic Gammiero
Chairman and Chief Executive Officer



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. ("Company", "Western", "us", "we", or "our"), on a consolidated basis, for the year ended December 31, 2010 to help security holders and other readers understand our Company and the key factors underlying our financial results. This discussion and analysis should be read in conjunction with the audited annual consolidated financial statements and related notes thereto, for the years ended December 31, 2010 and 2009.

The Company has prepared the financial information contained in this discussion and analysis in accordance with Canadian generally accepted accounting principles ("GAAP"). Reference is also made to EBITDA¹. EBITDA is defined as operating income (loss) plus amortization of property, plant and equipment and the write-down of property, plant and equipment and operating restructuring costs added back. 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 and property write-downs are not 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 Canadian GAAP 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 GAAP, and should not be considered as an alternative to measures of performance under GAAP. 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 our MD&A in this annual report. All written and oral forward-looking statements or information attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements. Except as required by law, Western does not expect to update forward-looking statements or information as conditions change.

Unless otherwise noted, the information in this discussion and analysis is updated to February 23, 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.

¹ Earnings Before Interest, Tax, Depreciation and Amortization

Overview

Our operating results in 2010 were improved over the results of the previous three years as the impact of the global recession which started in 2008 began to ease off in 2010. The Company also took further steps to improve financial results by reducing operating costs, matching working capital to demand, and seeking out new markets for its products. Demand for our log and lumber products showed modest increases in 2010 compared to 2009, with demand from China and Japan driving the majority of the growth. As a result, the Company was able to restart idled sawmill facilities at Somass, Nanaimo, and Ladysmith, and certain of our timberland operations, thereby contributing margin against the fixed costs of our previously idled operations. The effects of our increased production, combined with Western's dedicated focus on cost cutting measures has led to significantly reduced unit operating costs in 2010 compared to 2009. Pricing of lumber products increased in 2010 as excess worldwide inventories were absorbed, but remains well below trend levels. However, the Canadian dollar strengthened against the US dollar during the year reducing the Company's Canadian dollar revenues from sales made in most foreign currencies. Despite the improvement in operating results, management believes that modest global economic recovery and limited worldwide lumber inventories will lead to market volatility over the next few years.

Western's sales in 2010 amounted to \$667.9 million, representing an increase of \$87.4 million, or 15.1%, from the prior year. The increase in sales in 2010 was the result of higher shipment volumes for lumber, logs and by-products which was partially offset by marginally lower average prices realized for lumber and logs sold. Average lumber prices realized were lower in 2010 than 2009 despite US dollar denominated product prices increasing because of the negative impact of exchange rates.

Our net income of \$27.7 million in 2010 was an improvement of \$103.0 million from the loss of \$75.3 million incurred in 2009. The increase in income was primarily attributable to increased shipments of both logs and lumber in 2010 combined with reduced cost of goods sold. Selling and administration costs were similar over the two years but interest costs were higher in 2010 due to higher average interest rates. Significantly higher non-recurring gains were realized on asset sales in 2010 compared to 2009.

As a result of our improved operating results in 2010, the financial position of the Company improved over the course of the year. Liquidity increased from \$37.3 million at the close of 2009 to \$84.6 million as at December 31, 2010. This improvement was driven by a combination of improved cash generation and increased availability on the revolving credit line due to a higher asset borrowing base. There was no balance outstanding on the revolving credit facility at December 31, 2010 compared to \$15.3 million at December 31, 2009.

On August 23, 2010 the Company announced the ratification of an agreement with the United Steelworkers Union ("USW") who represent approximately 1,600 of Western's 1,700 hourly employees. Key provisions of the agreement include a four year term expiring on June 15, 2014 with annual wage increases of 0%, 0%, 2% and 2% respectively. The Company's last contract with the USW, the Coast Master Agreement, expired on June 15, 2010.

In September, 2010 the Ladysmith sawmill was re-started after having been idled since April 2008 due to poor market conditions. The operation currently now employs approximately 30 workers operating on a one shift basis, and is producing lumber to service the market in China. In conjunction with the Ladysmith start-up, Western also announced the ratification of a new labour agreement with Local 8 of the Pulp and Paper Workers of Canada Union ("PPWC"), which represents the hourly employees at the Ladysmith sawmill.

Western re-started its previously idled Nanaimo sawmill in November 2010. The operation employs approximately 30 workers and is servicing the lumber markets in Japan, China and North America.

During 2010, Western completed the sales of a number of non-core assets realizing proceeds of \$16.1 million compared to \$7.0 million in 2009. The majority of these proceeds were used to repay long term debt. The most significant of these transactions in 2010 was the sale of certain non-core properties to the Capital Regional District, British Columbia ("CRD") for a purchase price of \$14.3 million which was recognized in the third quarter of 2010 (for more details on this transaction see *Other income* – Page 8). In addition to these property sales, the Company recognized a gain of \$8.9

million relating to the receipt in January 2010 of the balance of the contingent proceeds following the establishment of a jointly-owned entity in October 2009 with Brookfield Properties Limited (“BPL”), a company related to Brookfield Asset Management Inc. (“BAM”).

As economic and other circumstances allow, Western will continue to pursue opportunities to sell non-core assets or private timberlands. Should any such sales be completed, proceeds will initially be directed towards retirement of the Company’s long-term debt.

In December 2010, the Company received a compensation payment of \$5.2 million from the Province of British Columbia for outstanding Bill 28 (Forestry Revitalization Act), or “FRA”, impacts which had resulted from deletions from our forest tenures. This amount was compensation for improvements, engineering and strategic inventory information associated with FRA withdrawals of the external timber licences in 2004 and 2005.

In December 2010, the Company amended its term loans, extending the maturity date of its \$75.0 million revolving term loan and \$31.2 million non-revolving term loan to June 14, 2013 and December 14, 2012, respectively. In addition, pricing for the term loans has improved. All other terms and conditions of the term loans remained substantially unchanged. In December 2010, the Company also amended its revolving credit facility, extending the maturity date to December 14, 2015.

Selected Annual Information ⁽¹⁾

	Year ended December 31,		
	2010	2009	2008
<i>(millions of dollars except where noted)</i>			
Sales	\$ 667.9	\$ 580.5	\$ 814.8
EBITDA ⁽²⁾	47.7	(34.8)	(42.4)
EBITDA as % of sales	7.1%	(6.0)%	(5.2)%
Operating income (loss)	17.3	(69.8)	(82.4)
Net income (loss) from continuing operations	29.2	(73.3)	(80.4)
Net income (loss) and comprehensive income (loss)	27.7	(75.3)	(85.6)
Basic and diluted net income (loss) per share <i>(dollars)</i>	\$ 0.06	\$ (0.17)	\$ (0.42)
Total assets	\$ 587.1	\$ 576.0	\$ 726.0
Net debt ⁽³⁾	99.8	126.9	233.0

⁽¹⁾ Included in Appendix A is a table of selected results for the last eight quarters and a reconciliation of EBITDA to net income (loss).

⁽²⁾ Non-GAAP measure - see page 3 for discussion on EBITDA.

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

Continuing Operations

Net income (loss) from continuing operations

Net income from continuing operations in 2010 increased by \$102.5 million from the prior year loss. Sales totaled \$667.9 million, which was an increase of \$87.4 million over 2009, or 15.1%. The improvement in net income from continuing operations primarily comprised a turnaround in operating income of \$87.1 million and an increase in other income of \$16.9 million.

EBITDA

EBITDA improved by \$82.5 million from 2009, primarily due to a significant reduction in the cost of lumber and logs sold, and an increase in the volume of sales, particularly of logs. The reduction in cost of lumber sold was driven by lower unit costs as a result of higher production levels and the associated efficiencies. In particular, fixed costs incurred at curtailed operations were significantly less than the previous year. Fibre costs for the year were also lower than in 2009, mainly because of lower stumpage rates and reduced operating costs. Provincial stumpage rates are calculated from formulas that consider historic Vancouver log market prices, harvesting costs and log market bidding activity. Rates established by the Province of British Columbia dropped in 2009, but the effects of the lower rates were not fully realized in 2009 as the Company worked through opening inventories which contained logs at higher stumpage rates. In 2010, the full benefit of the lower rates was realized.

During 2010, the Company took significantly less downtime in both its timberland and manufacturing operations. Total log harvest of 4.6 million cubic meters was 47% higher than the 2009 harvest levels, while lumber production was 23% more than during 2009. Our sawmills operated at 63% of total capacity in 2010 compared to 48% of capacity in 2009. This increase primarily reflects the fact that our Somass sawmill ran for most of 2010 but for only a small part of 2009, and the Nanaimo and Ladysmith sawmills started up in the latter part of 2010, having been down for all of 2009. Unavoidable fixed costs of \$24.8 million associated with curtailed operations were directly expensed to the income statement in 2010, which is \$7.6 million less than the amount expensed in 2009.

While much of the year over year improvement in Western's EBITDA is the result of higher utilization of our operations, the benefits of Western's ongoing cost reduction initiatives, albeit to a lesser degree, also contributed to the reduced cost of sales. The cost reductions took the form of reduced headcount, salary reductions, decreased spending, and deferred road spending. In conjunction with reduced costs, operations focused on margin positive programs and worked to increase the volume of such programs. The lumber sales and marketing group refocused the business on four key market categories – commodity, niche, cedar, and Japanese programs, each with unique attributes and strategies.

Selling and administration expenses in 2010 were \$24.5 million (2009 - \$24.7 million). These expenditures have stabilized following two years of significant reductions, as the Company restructured its organizational needs to adapt to a new operating environment.

Operating income (loss)

In addition to the EBITDA improvements described above, the Company recorded a restructuring expense of \$1.6 million, \$3.9 million lower than the equivalent expense of \$5.5 million in 2009. The restructuring charges in 2010 primarily relate to severance costs incurred in Western's Japanese sales organization, the Mid-Island Remanufacturing operation, Andy's Bay logging facility, and the Ladysmith sawmill. In 2009, severance costs were mostly related to timberlands operations.

Sales

<i>(millions of dollars)</i>	Year ended December	
	31,	
	<u>2010</u>	<u>2009</u>
Lumber	\$ 475.1	\$ 438.2
Logs	139.0	99.6
By-products	53.8	42.7
Total sales	<u>\$ 667.9</u>	<u>\$ 580.5</u>

Lumber sales in 2010 were \$36.9 million or 8.4% higher than in the prior year. Western shipped 669 million board feet in 2010, which was up 10.0% from the 608 million board feet sold in 2009 while average prices realized for lumber decreased 1.5%. The average annual Canadian dollar to US dollar exchange rate was 9.6% stronger for 2010 compared to 2009, which more than offset the increase in US dollar denominated lumber pricing year over year.

The majority of our lumber volume increase was attributable to higher shipments to Japan and China, as well as a marginal increase in domestic sales. Partially offsetting this were lower shipments to the US and Europe in 2010 as markets there continue to be relatively depressed, driven largely by their respective weak economic conditions. Housing starts in the US continue to be near historically low levels and existing home inventory levels remain high.

There was no clear pattern with respect to a year-on-year comparison of our lumber product pricing, with variability depending upon product grade and market. Overall, our lumber prices increased in 2010, most noticeably on our shipments to Japan and China. However, our overall average prices achieved per board foot sold in 2010 were slightly lower than 2009. This reflects the negative impact on revenues of the stronger Canadian dollar as the majority of sales are denominated in US dollars, and also the higher proportion of relatively lower price commodity lumber produced in 2010 for the China market. Partly offsetting these was the positive impact of increased sales to the Japanese market, and also the benefits resulting from the relative strength of the Japanese Yen to the Canadian dollar in 2010 compared to 2009.

Total lumber freight and duty costs for 2010 on a per unit of sold production basis were not significantly different from the previous year. Increased availability of traditional ocean break-bulk vessels meant we were able to ship approximately 10% more break-bulk this year and correspondingly less by higher cost container. The savings associated with this increased use of break-bulk were offset by the higher freight costs of the increased level of shipments to our China and Japan markets in 2010. Both truck and rail freight rates remained unchanged for much of 2010, although increased diesel prices have resulted in increased surcharges.

Log sales in 2010 increased \$39.4 million or 39.6% compared to the prior year. The increase was primarily due to the quantity of logs shipped being 46.9% higher in 2010 as a result of increased demand for logs both domestically and internationally. Demand and prices were particularly strong in export markets such as Korea, China, and Japan. While log prices were higher for most log sorts in 2010, average prices realized were 4.8% lower when compared to 2009 as a result of a change in the mix of sales. Proportionately increased sales of the lower priced hemlock and pulp logs and less of the higher value cedar logs occurred in 2010.

Sales of by-products in 2010 were \$11.1 million, or 26.0%, higher than in 2009 which is mostly the result of a 25% increase in chip prices received in 2010 compared to 2009. Chip prices are tied by a formula to the price of pulp which increased in 2010 compared to 2009, thus driving chip prices higher. Western has various obligations under long-term chip supply contracts which require us to either purchase quantities of chips on the open market or use whole log chipping programs at certain sawmills and third party chipping facilities, if insufficient chips are produced from our own mills. In addition, approximately \$1.5 million higher revenue was received from sawdust and hog fuel sales in 2010 due to increased sawmill production volumes during the year.

Net interest expense

The interest expense for 2010 of \$12.4 million was \$1.6 million more than the expense of \$10.8 million incurred in 2009. The increase was primarily caused by higher average interest rates in 2010 compared to 2009, which more than offset the impact of lower overall average debt levels in 2010. Interest rates increased following the extension of the expiry date of the non-revolving term loan from September 9, 2009 to September 9, 2010. Concurrent with this extension, the interest rate margin charged increased by 3%, and became, at the Company's option, either Canadian prime rate plus 5% or bankers' acceptance rate plus 6%. In addition, the interest rate margin increased by a further 0.25% at the end of each calendar quarter commencing December 31, 2009. New financing terms will apply in 2011 following the refinancing completed in December 2010.

Other income

Other income increased from \$7.4 million in 2009 to \$24.3 million in 2010 and was comprised of gains on the disposal of non-core assets of \$8.6 million; a gain of \$8.9 million (net of costs of \$0.5 million) related to the establishment of a jointly-owned entity with BPL in October 2009 (see "Financial Instruments, Off-Balance Sheet Arrangements, Foreign Exchange and Related Party Transaction" section for further details); a further receipt of \$5.2 million from the Province of British Columbia relating to compensation with respect to Bill 28 timber take-back areas; and other miscellaneous

items aggregating to \$1.6 million. \$16.1 million of the proceeds received from the sales of non-core assets in 2010 was used to pay down long-term debt (2009 - \$6.4 million).

The most significant property transaction was the sale to CRD of land located in the southern part of Vancouver Island for proceeds of \$14.3 million, which closed in August 2010. As part of this transaction, the Company also agreed to sell a further two parcels of land for proceeds of \$4.5 million which, as a condition of sale, require the Company to secure a Certificate of Compliance on an environmental remediation project currently under way. The Company has until August 15, 2012 to secure that certificate, and until the certificate is obtained this element of the sale will not be recorded. At December 31, 2010, \$9.7 million of the proceeds had been received with \$3.3 million due on August 12, 2011 and a further \$5.8 million on August 15, 2012, assuming that the aforementioned certificate is obtained. The transaction generated an accounting gain of \$7.1 million.

Other income of \$7.4 million received in 2009 relates to gains on non-core asset sales and also to compensation payments received from the Province of British Columbia for the reimbursement of infrastructure costs incurred in certain expropriated timber tenures following the creation of new Conservancies in the Central Coast region.

Income taxes

There was no income tax expense incurred in 2010, and a minimal amount was recorded in 2009. The 2009 expense relates primarily to the Company's Japanese subsidiary.

At December 31, 2010, the Company and its subsidiaries have unused non-capital tax losses carried forward totaling approximately \$420.0 million, which expire between 2015 and 2030, and can be used to reduce taxable income. In addition, the Company has capital losses of approximately \$22.5 million, which are available indefinitely, but can only be utilized against capital gains. The ability of the Company to utilize the losses carried forward and capital losses is not considered "more likely than not" and therefore, a valuation allowance has been provided against the tax assets.

Discontinued Operations

Operations of the site of the former Squamish pulp mill were discontinued in 2006. Since that date, the Company has expensed costs as incurred for supervision, security, property taxes and environmental remediation and will continue to do so until the site is sold. In 2010, the Company incurred costs of \$1.5 million with respect to the site which is less than the \$2.0 million expensed in 2009. Less remediation work was undertaken on the site during 2010 compared to 2009. The Company continues to investigate opportunities to reduce operating costs of the site, including the sale of energy generated from its hydro electrical generating plant when required permits are in place. The Company has the property listed for sale and will pursue opportunities for sale as economic and other circumstances allow.

Financial Position and Liquidity

	Year ended December 31,	
	2010	2009
<i>(millions of dollars except where noted)</i>		
Cash provided (used) by operating activities	\$ 28.5	\$ 63.2
Cash provided (used) by investing activities	3.7	(1.9)
Cash provided (used) by financing activities	(33.7)	(53.6)
Cash used to construct capital logging roads	(7.8)	(3.5)
Cash used to acquire other property, plant, and equipment	(3.8)	(5.4)
<hr/>		
Total liquidity ⁽¹⁾	84.6	37.3
Net debt ⁽²⁾	99.8	126.9
Financial ratios:		
Current assets to current liabilities	2.49	1.31
Net debt to capitalization ⁽³⁾	0.25	0.31

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

(2) Net debt defined as the sum of long-term debt, current portion of long-term debt, revolving credit facility, less cash and cash equivalents. Capitalization comprises net debt and shareholders' equity.

(3) Capitalization comprises net debt and shareholders' equity

Cash provided by operating activities in 2010 amounted to \$28.5 million, which is less than the \$63.2 million provided in 2009. Although cash generated by operating activities before working capital changes improved by \$101.9 million during 2010, the Company generated \$136.6 million less from working capital in 2010. The Company significantly reduced funds invested in working capital in 2009 and generated cash of \$114.0 million. The most significant element of the reduction was the \$121.2 million generated from lower inventories at December 31, 2009 compared to the end of 2008. During 2010, Western increased working capital by a net \$22.6 million, mainly because of increased levels accounts receivables and inventories, which reflects the building level of sales activity during 2010.

Investing activities generated cash of \$3.7 million, which compares to cash used by investing activities of \$1.9 million in 2009. The difference primarily relates to the increased level of cash received from non-core asset sales in 2010 compared to 2009. In addition, expenditures on property, plant and equipment of \$11.6 million in 2010 were \$2.7 million more than was spent in 2009. Capital expenditures continued to be monitored closely in 2010, primarily limited to road construction that was essential to the log harvesting program, maintenance and safety projects, and some smaller high return projects.

Financing activities in 2010 used cash of \$33.7 million compared to \$53.6 million in 2009. Western's improved operating cash flow generated in 2010 enabled it to clear the balance of \$15.3 million outstanding on its revolving credit facility. In addition, debt repayments of \$16.1 million were made during 2010 on the non-revolving term loan from the proceeds of non-core asset sales (2009 - \$6.4 million). In 2009, the Company closed a rights offering to all shareholders which realized net proceeds of \$49.6 million. These funds, together with the proceeds from the reduction in working capital during 2009, enabled the Company to reduce the balance outstanding on its revolving credit facility by \$93.6 million to \$15.3 million at December 31, 2009.

At December 31, 2010, Western's total liquidity had increased to \$84.6 million from \$37.3 million at the end of 2009. Liquidity is comprised of cash of \$5.1 million and unused availability under the secured revolving credit line of \$79.5 million. The increase is a function of increased availability under the amended financing agreements, the fact that improved cash generated from operations meant less was drawn down on the revolving credit facility, and a higher borrowing base due to increased balances of eligible inventories and receivables at the end of 2010.

Any net proceeds realized from the sale of non-core assets will be utilized to repay the term loan.

Based on its current forecasts the Company expects sufficient liquidity will be available to meet its obligations in 2011.

Fourth Quarter Results

	Three months ended	
	December 31,	
	2010	2009
<i>(millions of dollars except where noted)</i>		
Sales	\$ 172.6	\$ 139.3
EBITDA	7.1	2.3
EBITDA as % of sales	4.1%	1.7%
Net income (loss) from continuing operations	4.3	(2.7)
Net income (loss) and comprehensive income (loss)	4.0	(3.1)
Basic and diluted net income (loss) per share (dollars)	\$ 0.01	\$ (0.01)

Our net income of \$4.0 million reported in the fourth quarter of 2010 was a \$7.1 million improvement over the loss of \$3.1 million incurred in the same quarter of 2009. The improvement was driven primarily by a \$4.8 million increase in EBITDA and an improvement of \$1.6 million in non-operating items. The improvement in EBITDA in the fourth quarter of 2010 was the result of increased shipments in 2010 with lumber and log sales volumes being 20.0% and 22.3% higher than the fourth quarter of 2009 respectively. The overall average selling price realised for lumber sales in the current quarter was 2.2% higher than the fourth quarter of 2009, as the combined benefit of slightly higher prices more than compensated for the negative impact on revenues of a 4.1% strengthening of the Canadian dollar relative to the US dollar over the same period. In order to meet improved demand our mills operated at 76% of capacity in the fourth quarter of 2010, compared to 48% in the same period of 2009, which resulted in fixed shutdown costs incurred in 2010 being \$3.7 million less than those incurred in 2009. Also contributing to the improved result in 2010 were higher volumes and prices for chip sales compared to the fourth quarter of 2009.

Selling and administration expenses in the fourth quarter of 2010 were \$2.0 million more than the same period last year mainly as a result of increased employee costs due to salaries being reinstated after a 10% reduction the previous year, and increases in stock based compensation. The improvement in non-operating items primarily relates to other income in the fourth quarter of 2010 being \$0.8 million higher than that reported in the fourth quarter of 2009, and interest charges being lower in the fourth quarter of 2010 by \$0.6 million compared to the fourth quarter of 2009, primarily as a result of lower average debt levels in the current quarter.

Outlook and Strategy

The restructuring efforts that Western commenced in 2009 have started to show up in the stronger financial results of the Company in 2010. During the course of 2010, the Company improved its operating results, strengthened its balance sheet and secured long term financing. The Company expects to build on these positive results in 2011 and beyond. With these improved financial results, particularly the improved liquidity situation, management is beginning to focus more on longer term strategic goals. These longer term key strategic objectives include:

- Growing market share in traditional and developing export markets
- Operating all our mills at capacity, realizing full economies of scale, while fully utilizing our annual allowable cut
- Generating substantial free cash flow that justifies re-investment

A key aspect of this strategy is diversifying our sales across four major market categories (western red cedar; Japan; niche; and commodity) and scaling our production to that demand.

Growth in the cedar market will be heavily dependent on the US housing market recovery. Despite signs that US housing starts will increase in 2011, we continue to be concerned over the high levels of US unemployment, limited access to credit and the continuing high level of foreclosures in the housing market. We expect the recovery of the US housing market will be gradual and unpredictable.

Our commodity programs are currently focused on delivering product to China. China continues to be an important growth story for Western, driving the startup of idled mills in the fourth quarter of 2010. While the demand for wood products in China has been primarily generated by concrete forming needs, new approvals for wood home construction are expected to increase demand for higher value wood products. We expect China to be our highest volume market in 2011.

We will also continue to monitor the opportunity to re-enter the commodity market in the US. We expect there will be short lived price spikes in commodity products but that sustainable price increases are unlikely until housing starts return to historical trend levels in the US.

We are expecting housing in Japan to continue its steady rebound, providing opportunities for our Douglas fir and hemlock lumber products. This market continues to be very competitive, with many international suppliers and a government supported domestic industry.

Niche lumber programs are directed at small, high value global markets, with demand being driven by regional economic conditions. The timber segment presents a good growth opportunity and we will also look to expand our appearance quality custom cut programs. Europe's uncertain economic situation will hamper niche sales growth in that region, but as a high value market it continues to be attractive and we will continue to pursue market share gains.

Another key aspect of our strategic focus will be continuing to grow the business, including investment in our capital assets to position them to be competitive in the future. Over the next four years, the Company plans to embark on a \$125 million strategic capital program. The program, largely targeted at our sawmill facilities, will increase kiln capacity, add small log capabilities, and generally reduce operating costs.

As we continue to grow the business, it is imperative that we effectively manage the capital employed. Western continues to be focused on balancing its log and lumber production with demand. Incremental increases in production are judged on the sustainability of any increased demand from markets. The Company remains cautious about the short term strength of the global economic recovery, particularly in light of the ongoing economic challenges facing the United States and European countries. However, we have a greater capacity to weather another crisis having strengthened our liquidity position and solidified our balance sheet.

On February 11, 2011, the Company completed the sale of certain non-core properties to TimberWest Forest Corp. at the purchase price of \$21.9 million. The sale includes 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 will be used to pay down the Company's debt in accordance with its lending agreements.

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

Summary of Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2010 and our payments due for each of the next five years and thereafter:

2010

<i>(millions of dollars)</i>	Total	2011	2012	2013	2014	2015	Thereafter
Revolving term loan	75.0	-	-	75.0	-	-	-
Non-revolving term loan	31.2	-	31.2	-	-	-	-
Operating leases	16.7	3.4	2.3	1.5	1.3	1.3	6.9
Reforestation liability	26.1	11.4	4.6	2.7	1.7	1.2	4.5
Defined benefit pensions							
- funding obligations	12.4	2.9	2.9	2.2	2.2	2.2	-
Total	\$ 161.4	17.7	41.0	81.4	5.2	4.7	11.4

Critical Accounting Estimates

Reforestation Liabilities

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

Valuation of Inventory

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

Valuation of Accounts Receivable

We record an allowance for the doubtful collection of accounts receivable based on our best estimate of potentially uncollectible amounts. The best estimate considers past experience with our customer base and a review of current economic conditions and specific customer issues. The Company's general practice is to insure substantially all lumber receivables, both export and domestic, for 90% of value with the Export Development Corporation or Coface Canada, respectively, or sell on a cash basis, which significantly reduces the Company's exposure to bad debts.

Pension and Other Post Retirement Benefits

Western has various defined benefit and defined contribution plans that provide pension benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. The Company also provides other post retirement benefits and pension bridging benefits to eligible retired employees. With respect to the defined benefit plans, we retain independent actuarial consultants to perform actuarial valuations of plan obligations and asset values, and advise on the amounts to be recorded in the financial statements. Actuarial valuations include certain assumptions that directly affect the fair value of the assets and obligations and expenses recorded in the financial statements. These assumptions include the discount rate used to determine the net present value of obligations, the return on plan assets used to estimate the increase in the plan assets available to fund obligations and the increase in future compensation amounts and medical and health care costs used to estimate obligations. Actual experience can vary materially from the estimates and impact the cost of our pension and post retirement medical and health plans and future cash flow requirements.

Environment

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

Contingencies

Provisions for liabilities relating to legal actions and claims require judgments using management's best estimates regarding projected outcomes and the range of loss, based on such factors as

historical experience and recommendations of legal counsel. Actual results may vary from estimates and the differences are recorded when known.

Changes in Accounting Policies

Inventories

On January 1, 2010, the Company changed its accounting policy for the costing of lumber inventories from the distributed cost method to the average cost of production method. Under the new policy, costs of lumber produced will 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. This compares to the former policy, which allocated costs based on the estimated fair value of the lumber products manufactured. Costs for logs produced will continue to be allocated based on the estimated fair value of the logs produced. Management believes that this change in accounting policy provides more reliable and relevant information to the users of the financial statements as it is more consistent with industry accounting practices, aligns with the Company's new profit centre strategy, and also results in a more conservative carrying value relative to the previous method used.

This change in accounting policy, which was implemented effective January 1, 2010 on a retrospective basis without restatement of prior periods, resulted in inventory reducing by \$2.4 million to \$105.2 million from \$107.6 million and the deficit increasing to \$327.2 million from \$324.8 million as at January 1, 2010. Prior periods have not been restated as the detailed information required to implement the new policy on a retrospective basis is not available.

Future Changes in Accounting Policies

International Financial Reporting Standards ("IFRS")

International Financial Reporting Standards (IFRS) will replace Canadian generally accepted accounting principles (CGAAP) for publicly accountable enterprises for financial periods beginning on or after January 1, 2011. Accordingly, the conversion from CGAAP to IFRS will be applicable to the Company's reporting for the first quarter of 2011 for which current and comparative information will be prepared under IFRS.

IFRS Transition Plan

The tables below describe the key elements of Western's IFRS changeover plan, significant milestones and progress to date or expected completion.

Financial Reporting

<i>Milestones</i>	<i>Progress to Date/Expected Completion</i>
Initial impact assessment and scoping	Completed all key areas.
Assessment of key accounting and reporting differences	Completed – as reported in the 2009 Annual MD&A report.
Identification, evaluation, selection and approval of IFRS accounting polices and IFRS 1 elections	IFRS accounting policies and IFRS 1 elections selected by senior management and approved by the Audit Committee.
Development of IFRS financial statement format, including disclosures (Q1 2011 interim statements will be prepared such that they will largely comply with anticipated annual disclosures given the enhanced disclosures in transition year)	Drafted a preliminary set of Q1 2011 pro-forma interim statements – in process of being reviewed by senior management and Audit Committee.
Preparation and review of Canadian GAAP / IFRS reconciliation of financial results for 2010 (required to be included in transitional statements)	Partially completed. Balance of reconciliations to be completed in the first quarter of 2011.
MD&A disclosure quantifying the effects of conversion on the 2010 comparative period	Completed in first quarter of 2011.

Training and Communication

<i>Milestones</i>	<i>Progress to Date/Expected Completion</i>
Training key finance and operational staff directly engaged in the changeover	Ongoing with planned completion during the first quarter of 2011.
Provide education and communicate progress of IFRS conversion to executive management and Audit Committee	Technical updates provided to Audit Committee and management throughout the implementation.

Information Technology, Systems and Processes

<i>Milestones</i>	<i>Progress to Date/Expected Completion</i>
Identify, implement and test changes to systems and processes (i.e. changes to chart of accounts)	<p>Identification – completed during second quarter of 2010.</p> <p>Implementation – new fixed asset coding to facilitate tracking of impairment/amortization completed. Implementation and testing – to be completed during the first quarter of 2011.</p>
Prepare statement of opening financial position under IFRS and compile dual reporting records during 2010	Review of opening financial position under IFRS in progress. Key items currently being reviewed by our external auditors. Dual accounting reconciliation in effect for 2010 comparatives.
Implement financial planning and forecasting under IFRS	Completed in the fourth quarter of 2010.

Contractual Arrangements and Compensation

<i>Milestones</i>	<i>Progress to Date/Expected Completion</i>
Assess impact on contractual arrangements and covenants and Implement changes as necessary	No material impact on contractual arrangements identified.

Control Environment and Internal Control over Financial Reporting

<i>Milestones</i>	<i>Progress to Date/Expected Completion</i>
Approval of initial IFRS 1 elections and accounting policy choices	IFRS accounting policies and IFRS 1 elections reviewed by senior management and discussed with the Audit Committee and subsequently approved. Ongoing – periodic review of implementation progress, impacts of outstanding IFRS exposure drafts, and IFRS policy decisions.
Testing of controls for 2010 comparatives	Planned for completion during the first quarter of 2011.

Update CEO/CFO certification process to respond to new IFRS reporting requirements	Upon completion of required process changes, testing procedures and documentation will be updated as necessary.
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Disclosure Controls and Procedures

<i>Milestones</i>	<i>Progress to Date/Expected Completion</i>
Review and approval by senior management of annual IFRS disclosures	Draft set of Q1 2011 interim financial statements, including notes - in the process of being reviewed by senior management and Audit Committee.
Review and approval by senior management of expected conversion effects and associated disclosures on fiscal 2010	Complete.
Prepare first quarter 2011 financial results with 2010 comparatives in accordance with IFRS; Provide MD&A disclosure of final changeover impacts	Planned for completion in the first quarter of 2011 with appropriate reviews/sign-offs.

Impact of Adoption of IFRS

IFRS are premised on a conceptual framework which is similar to CGAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. The following paragraphs outline the significant accounting policies, which are required or are currently expected to be applied by the Company upon its adoption of IFRS, which will be significantly different than its current CGAAP accounting policies.

These paragraphs also outline the material expected adjustments to the balance sheet as a result of these significant accounting policy choices and IFRS1 elections. While the adoption of IFRS is not expected to have a material impact on the reported cash flows of the Company, it is expected to have a material impact on the Company's consolidated balance sheet and statement of operations, comprehensive income (loss) and deficit. The overall impact of these estimated adjustments is a net increase to Western's shareholder's equity in the range of \$10 million to \$30 million.

Presentation

The balance sheet presentation of assets currently disclosed under CGAAP within the single heading of Property, Plant and Equipment will now be required to be shown as three separate balance sheet categories of asset:

- a. Intangible assets (crown tenures)
- b. Biological assets (the timber component of privately owned timberlands)
- c. Property, plant and equipment (all other property, plant and equipment excluding a. and b.)

Property, Plant and Equipment

Under International Accounting Standard (IAS) 16, *Property, Plant and Equipment*, an entity is required to choose, for each class of property, plant and equipment, to account for each class using either the cost model or the revaluation model. The cost model is generally consistent with CGAAP where an item of property, plant and equipment is carried at its cost less any accumulated depreciation and any accumulated impairment losses. Under the revaluation model, an item of property, plant and equipment is carried at its revalued amount, being its fair value at the date of the revaluation less any accumulated depreciation and accumulated impairment losses. The Company expects to use the cost model to account for all classes of property, plant and equipment, except for land, for which the revaluation model is proposed to be elected. As a result the Company will be required to revalue its land asset each period with any gains or losses taken directly to revaluation reserve or profit and loss.

As a result of the proposed election choice to use the revaluation model to value land on transition date, a net increase of approximately \$20 million to the currently reported CGAAP net book values is expected to be reflected in the asset category of property, plant and equipment, with a corresponding amount to be reported in the revaluation reserve component of other comprehensive income.

IFRS1 provides first time adopters of IFRS with the option to elect to measure an item of property, plant and equipment at its fair value at the transition date, which is considered to be its deemed cost thereafter.

The Company proposes to adopt this exemption for certain components of assets within the category property, plant and equipment. The net overall impact of adopting this election is not expected to have a material impact.

Intangible Assets

Under IFRS, crown tenures are expected to be considered an intangible asset with a finite useful life, and hence subject to IAS 38, *Intangible Assets*. The Company expects that the initial measurement of the tenures under IFRS will be at historic cost, less accumulated amortization and accumulated impairment charges. Such intangible assets are required to be presented as a separate line item in the balance sheet, and will be amortized over the expected useful life of the asset.

Impairments

Under CGAAP, assets other than financial assets are generally tested for impairment using a two-step approach: first comparing asset carrying values with undiscounted future cash flows to determine whether impairment exists; and then measuring any impairment by comparing asset carrying values with fair values. Under IFRS, IAS 36, *Impairment of Assets*, a one-step approach is used for both testing for and measurement of impairment, with asset carrying values compared directly with the higher of fair value less costs to sell, and value in use. This may potentially result in more write-downs where carrying values of assets were not previously impaired under CGAAP when compared to undiscounted cash flows, but could be impaired under IFRS when compared to fair value or value in use. However, the extent of any new write-downs may be partially offset by the requirement under IAS 36 to reverse any previous impairment losses where circumstances have changed such that the impairments have been reduced. CGAAP prohibits the reversal of impairment losses.

As a result of applying IAS 36 to its finite-lived intangible assets on the transition date (the crown tenures), Western currently expects to recognize an impairment to these assets of approximately \$50 million. As a result, it is expected that the Intangible Asset category will be reduced by this amount with a corresponding charge taken directly to retained earnings.

In addition, Western currently expects to recognize an impairment to property plant and equipment in respect of sawmill buildings and equipment, of approximately \$15 million with a corresponding charge to retained earnings.

Biological Assets (Standing Timber)

Unlike CGAAP, biological assets are specifically addressed under IFRS (IAS 41 – *Agricultural Assets*). The timber component of the Company's private timberlands will qualify as a biological asset under the scope of IAS 41. This timber would be reclassified and shown as a separate line item on the Company's balance sheet. The fair value of biological assets for Western would be measured by discounting expected cash flows from the sale of standing timber at a current market determined rate. This value would include not only the harvest value but also would include a value for potential future growth. All gains and losses from changes in fair value are recognized in profit and loss. The agricultural produce (logs) from the biological asset are measured at fair value less costs to sell, which becomes the deemed cost for the purpose of subsequent accounting under the IAS 2, *Inventories* standard.

Western currently expects an increase to this asset category of approximately \$70 million at January 1, 2010 with a corresponding increase taken directly to retained earnings. Future

changes in fair value of these biological assets will be recognized in the Company's profit and loss going forward.

Provisions, including asset retirement obligations

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, has a lower recognition threshold for provisions and measurement differences when compared to CGAAP. These measurement differences include the requirement to reflect the risks associated with asset retirement obligations, such as silviculture obligations, in either the cash flows or in the discount rate used. The silviculture asset retirement obligations will be discounted using the risk free rate rather than the Company's credit adjusted risk free rate.

As a result, Western expects an increase to the silviculture liability as calculated under CGAAP at the transition date of approximately \$2 million with a corresponding reduction to retained earnings.

Employee Benefits

Under CGAAP, the accrued pension benefit obligations in excess of plan assets for defined benefit pension plans is required to be disclosed within the notes to the consolidated financial statements. Under IFRS, IAS 19, *Employee Benefits*, requires the obligation in excess of plan assets to be recorded as a liability on the balance sheet. The adoption of IAS 19 is not expected to have a material impact on the financial results or balance sheet of the Company.

Share-Based Payments

The Company issues stock-based awards in the form of stock options that vest evenly over a five-year period. Under CGAAP, Western recognizes the fair value of the award, 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. Accordingly, this will result in a higher amount of each grant being recognized in income at a faster rate than under CGAAP. The adoption of IFRS 2 is not expected to have a material impact on the financial results or balance sheet of the Company.

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

Consequent to the acquisition of Cascadia Forest Products Ltd. in May 2006, the Company indemnified an entity related to BAM for a guarantee provided by the entity to a third party. As security for performance under this indemnity, the Company issued a debenture in favour of the related entity in the maximum amount of \$100 million secured over all of the Company's real property and all of the Company's personal property as at May 2006 and such property acquired thereafter. In the absence of any claims, the guarantee terminates on May 30, 2011 and if there is no liability accruing to the guarantor thereunder at that time, the Company will request that the debenture be discharged.

Except for the debenture discussed above, the Company does not have any financial instruments not recognized in the financial statements. Recognized financial instruments, consisting primarily of debt instruments, are discussed elsewhere in this discussion and analysis.

In the fourth quarter of 2008 the Company commenced a program to reduce the impact of volatile foreign exchange rates on Western's net income. The Company utilizes derivative financial instruments in the normal course of its operations as a means to manage its foreign exchange risk. Therefore, Western may purchase foreign exchange forward contracts or similar instruments to hedge anticipated sales to customers in the United States and Japan. The Company will not utilize derivative financial instruments for trading or speculative purposes. Western will consider whether to apply hedge accounting on a case by case basis and if the instrument is not designated as a hedge, the instrument will be fair valued and marked to market each accounting period.

To further assist in mitigating 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, which is for a notional amount of up to US\$80.0 million, matures on March 31, 2011, and allows for forward transactions with a maximum term for each transaction of up to one year. The maturity date is subject to automatic annual renewal subject to BAM notifying the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and to certain change of control provisions being invoked. The Facility is unsecured and is subject to a fee of 0.10% of the notional amount per annum. The Company does not consider the credit risk associated with this Facility to be significant. During 2010, the Company entered into contracts under the Facility to sell US dollars and Japanese Yen (JPY) forward in order to mitigate a portion of this foreign currency risk. At December 31, 2010, the Company had forward contracts in place to sell US\$2.1 million and JPY 2,250 million (2009 – nil). A net gain of \$1.1 million was recognized on contracts which matured in the year (2009 - \$3.4 million), which is included in sales in the Consolidated Statement of Operations, Comprehensive Income (Loss) and Deficit.

Other than the debenture discussed above and operating leases for vehicles, equipment and machinery, the Company does not have any off-balance sheet financial arrangements as at December 31, 2010.

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 BPL. The HBU Properties were formerly part of the group of properties 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 total cash proceeds of \$12.4 million, of which \$3.0 million was received in October, 2009 with the balance of \$9.4 million being received 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 represent non-core assets of the Company that were being held for sale. BPL is the manager of WFPFPL, which also holds Carma Developers LP, a limited partnership that carries on a land development business across Western Canada. Western's interest in WFPFPL, which was less than 5%, was accounted for using the cost method. Under the terms of the arrangement Western had the option to sell its interest in that entity to BPL for its fair market value at any time on or after January 1, 2011. On January 4, 2011, the Company exercised this option and sold its equity interest in WFPFPL to BPL for \$2.4 million, and the aforementioned right of first offer was extinguished.

Since BPL is a related party of Brookfield Special Situations Management Limited ("BSSML"), which is Western's largest shareholder, the transaction constituted a related party transaction under Multilateral Instrument 61-101.

In addition to the related party transactions identified elsewhere in this MD&A, the Company has or had certain arrangements with entities related to BAM to 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 during the year ended December 31:

	<u>2010</u>	<u>2009</u>
Costs incurred for:		
Log purchases	\$ 8.1	\$ 10.2
Other	4.8	3.7
	<u>\$ 12.9</u>	<u>\$ 13.9</u>
Income received for:		
Log sales	\$ 3.3	\$ 0.4
Other	9.4	0.3
	<u>\$ 12.7</u>	<u>\$ 0.7</u>

Risks and Uncertainties

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

Liquidity and Capital Resources

Western has reported net income for the last four quarters and positive EBITDA for the last five quarters ended December 31, 2010, significantly increasing its available liquidity. Since December 31, 2009, the Company has generated cash flow from operations of \$28.5 million, reduced its revolving credit facility and long term debt by \$31.4 million and re-negotiated and extended its revolving credit facility and term loans. The Company has forecasted financial results and cash flows for 2011, and as a result expects it will be able to continue as a going concern for the foreseeable future. These forecasts are based on management's best estimates of operating conditions, revenues and expenses in the context of the current economic climate, including the continued relatively challenging state of the forest products industry. Some of the major assumptions in this forecast relate to sales volumes and product mix, lumber prices, log and chip prices and the US dollar and Japanese Yen exchange rates. Other significant assumptions include production rates, the useful life of the assets, stumpage rates and the amount of the export tax on lumber shipped to the US.

Variable Operating Performance, Product Pricing and Demand Levels

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

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

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

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

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

International Business and Risks of Exchange Rate Fluctuations

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

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

Depending on product mix, destination and exchange rates, between 35% and 45% of our total product sales are denominated in US dollars and between 13% and 18% in Japanese Yen, while most operating costs and expenses are incurred in Canadian dollars, with small portions in US dollars and Japanese Yen. The Company's functional currency is the Canadian dollar and results of operations are reported in Canadian dollars. Significant variations in relative currency values, particularly significant changes in the value of the Canadian dollar relative to the US dollar, have had, and in the future could have, a material impact on our operating earnings and cash flows. We estimate that an increase or decrease of 1% in the value of the Canadian dollar compared to the US dollar and Japanese Yen would decrease or increase annual operating earnings by approximately \$2.6 million to \$3.0 million, and \$0.8 million to \$1.0 million, respectively.

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

On October 8, 2010, the United States Trade Representative wrote to Canada's International Trade Minister to request consultations under the SLA with respect to allegations of under-pricing of timber in the British Columbia interior and circumvention of export measures provided for in the SLA. On January 18, 2011, the United States triggered the arbitration provision of the SLA by delivering a Request for Arbitration. As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the Province of British Columbia and the British Columbia forestry industry. As the claim is specifically directed at British Columbia interior practices, it is not possible at this time to predict any potential direct or indirect impact it may have on Western, which operates predominantly on the coast of British Columbia.

Employees and Labour Relations

Hourly paid employees at our manufacturing facilities, timber harvesting operations and a small group of clerical workers are unionized. Currently we negotiate and administer six collective agreements. Our unionized employees are represented by the United Steel Workers (USW) or the Pulp, Paper and Woodworkers of Canada (PPWC). The collective agreement covering the majority of Western's unionized employees (Coast Master Agreement with the USW), was renewed in 2010 and expires on June 14, 2014. An agreement that covers employees at the Company's Ladysmith Sawmill Operation was also renewed in 2010 and now expires on December 31, 2014, and an agreement covering employees at the Value Added Remanufacturing operation was renewed until October 14, 2016. Two other agreements expire in 2012.

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

Long-Term Competition

The markets for our products are highly competitive on a domestic and international level, with a large number of major companies competing in each market. Many of our competitors have both substantially greater financial resources and less debt than Western. Some of these competitors are not subject to fluctuations in the relative value of the Canadian dollar to the same extent as Western. We also compete indirectly with firms that manufacture substitutes for solid wood products, including non-wood and engineered wood products. While the principal basis for competition is price, we also compete to a lesser extent on the basis of quality and customer service. Changes in the level of competition, industry capacity and the global economy have had, and are expected to continue to have, a significant impact on the selling prices and overall profitability of the Company. Our competitive position will be influenced by factors including the availability, quality and cost of fibre, energy and labour, and plant efficiencies and productivity in relation to our competitors. Our competitive position could be affected by fluctuations in the value of the Canadian dollar relative to the US dollar and/or the Japanese Yen, and by the export tax on softwood lumber shipments to the US.

Forest Resource Risk and Natural Catastrophes

Our timber tenures are subject to the risks associated with standing forests, in particular, forest fires, wind storms, insect infestations and disease. Procedures and controls are in place to mitigate such risk through prevention and early detection. Most of the timber that we harvest comes from Crown tenures and insurance coverage is maintained only for loss of logs due to fire and other occurrences following harvesting. However, this coverage does not extend to standing timber, and there is no assurance that this coverage would be adequate to provide protection against all eventualities, including natural catastrophes. Western has entered into a cost-sharing agreement with the Crown for our private timberlands to reduce individual incident costs of mobilizing helicopters and aerial water tankers in the event of a fire on those lands. In 2010 the British Columbia coast experienced normal summer conditions which resulted in only a few wildfires within our tenures.

In addition, our operations may be adversely affected by severe weather including wind, snow and rain that may result in our operations being unable to harvest or transport logs to our manufacturing facilities for extended periods of time. Although we anticipate and factor in a certain period of down-time due to weather, extended periods of severe or unusual weather may adversely impact our financial results due to higher costs and missed sales opportunities arising from fibre shortages or the deterioration of logs remaining on the ground or in the water for extended periods of time. In 2010, a series of very large storms through the month of September resulted in frequent shutdowns and damaged infrastructure at our northern Vancouver Island and central coast logging operations reducing log production.

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

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

While the Company maintains insurance coverage to the extent deemed prudent by us, we cannot predict that all potential insurable risks have been foreseen or that adequate coverage is maintained against known risks. With respect to the storm damage noted earlier, an insurance claim is being prepared and the Company is working with its insurers to quantify the amount of damage resulting from this event.

Impact of Mountain Pine Beetle Infestation

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

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

Pulp and Paper Market Variability

The selling price in Canadian dollars of our residual wood chips on some of our fibre contracts is tied by formula to the net pulp realizations in US dollars obtained by our wood chip customers. Fluctuations in pulp prices and foreign currencies will accordingly impact the selling price of our residual wood chips. The price and demand for the pulp logs and other logs sold to pulp and paper companies is also dependent on the market conditions for pulp and paper. If contraction in the coastal pulp and paper industry were to occur, we may need to find alternative customers for the pulp logs and residual chips from our sawmills.

Dependency on Fibre Obtained from Government Timber Tenures

Currently, substantially all of the timberlands in which we operate are owned by the Province of British Columbia and, until October 2010 were administered by the Ministry of Forests and Range. Government restructuring of resource Ministries has resulted in timberlands being administered by the Ministry of Forests, Mines and Lands as well as the Ministry of Natural Resource Operations. The *Forest Act* (British Columbia) ("Forest Act") empowers the Ministry of Forests, Mines and Lands to grant timber tenures, including Tree farm Licences ("TFLs"), Forest Licences ("FLs") and Timber Licences ("TLs"), to producers, although no new TLs can be issued and the availability of extensions to expiring TLs cannot be assured. The Provincial Chief Forester must conduct a review of the AAC for each Timber Supply Area and each TFL in the Province on a periodic basis, which is at least once every ten years. This review is then used to determine the AAC for licences issued by the Province under the Forest Act. Many factors affect the AAC such as timber inventory, the amount of operable forest land, growth estimates of young forests, regulation changes and environmental and social changes. Such assessments have in the past resulted and may in the future result in reductions or increases to the AAC attributable to licences held by British Columbia forest companies (without compensation), including the licences that we hold. In addition, our AAC can be temporarily reduced

(without compensation for the first four years) in areas where logging has been suspended under Part 13 of the Forest Act pending further consideration in land use planning. Land use planning and new harvesting regulations can constrain access to timber and new parks can permanently remove land from the timber harvesting land base. There can be no assurance that the amounts of such future reductions on our licences, if any, will not be material or the amounts of compensation, if any, for such reductions will be fair and adequate.

Forest Policy Changes in British Columbia

In October 2010 the Province implemented sweeping changes in how Crown land natural resource rights are administratively managed. Former sector specific Ministries (Forests, Mines, Environment, etc.) retained a policy development role but the administration of most tenure rights formerly managed by these Ministries was assigned to a single new Ministry, the Ministry of Natural Resource Operations. While the Province's intention was to make resource administration more effective and efficient, it remains to be seen if the desired improvements are realized.

First Nations Land Claims

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

First Nations are seeking compensation from governments (and in some instances from forest tenure holders) with respect to these claims, and the effect of these claims on timber tenure rights, including our timber tenures, cannot be estimated at this time. The Federal and Provincial Governments have been seeking to negotiate treaty settlements with aboriginal groups in British Columbia in order to resolve these claims. On April 1, 2011 the first modern day treaty affecting the Company's tenures is expected to come into force. The Maa'nulth Treaty will extinguish the Company's tenure rights on Maa'nulth Treaty Settlement lands within TFL 44 and will permanently reduce the tenure's AAC. The Company is in discussions with the Province on the magnitude of the treaty impacts on AAC, improvements, soft cost investments and downstream business. As these discussions are ongoing, any settlement or the amounts of compensation that we would receive for this or future takings from our tenures as a result of this process cannot be estimated at this time and none has been recorded as a receivable. Other treaty processes involving the Nam'gis, Sliammon and K'omox First Nations are also well advanced and may lead to agreements in principle in 2011.

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

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

Stumpage Fees

Stumpage is the fee that the Province charges forest companies for timber harvested from Crown land in British Columbia. In January 2004, the Provincial Government announced the move to a more open and competitive market pricing system for timber and logs for the coastal region. Previously, the amount of stumpage paid for each cubic metre of wood harvested from the coastal region was based on a target rate set by the Province. Since February 29, 2004, stumpage for the coastal region is being set using the Coast version of the Market Pricing System (“MPS”), which uses the results from British Columbia Timber Sales (“BCTS”) auctions to establish the value of Crown timber harvested under long-term tenures. Changes to the Coastal stumpage system effective April 1, 2011 have been announced but the details are not yet confirmed. The changes are expected to involve an update to the MPS calculation, and the supporting BCTS database is being updated to include 2009 and 2010 sales, which is expected to result in higher stumpage than the 2009 equivalent calculation. The Company is currently assessing the methodology with which the new equation will be implemented. There can be no assurance that future changes to the stumpage system or the Province’s administrative policy will not have a material impact on stumpage fees payable and consequently affect our financial condition and results of operations.

Long-term Fibre Supply Agreements

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

Safety

Western is subject to workplace safety laws and regulations. Failure to comply with these laws and regulations can result in monetary penalties and work stoppages. The laws and regulations change over time and may involve new methodologies and additional costs necessary to bring the Company into compliance.

Environmental Regulation

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

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

We may incur substantial costs to comply with current or future requirements, to respond to orders or directions made, to remedy or to compensate others for the cost to remedy problems for which we are legally responsible or to comply with new environmental laws that may be adopted from time to time. In addition, we may discover currently unknown environmental problems or conditions affecting our operations or activities or for which we are otherwise legally responsible. Western has closed

certain operations and although we have engaged specialists to advise us of environmental problems and conditions, normal site clean-up may identify additional problems or conditions. Any such event could have a material adverse effect on our financial condition and results of operations.

Regulatory Risks

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

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

Legal Proceedings

In January 2008 the Ditidaht First Nation commenced litigation in the B.C. Supreme Court against the Province of British Columbia, Canada, certain other First Nations and two forestry companies, including the Company, seeking amongst other things declarations of aboriginal title and rights in areas of Vancouver Island that include areas covered by timber tenures held by the Company and declarations that provincial forestry legislation and the Company's timber tenures are of no force or effect on the claimed aboriginal title lands. This proceeding is in the early stages and no trial date has been set.

In April 2008 the Kwakiutl First Nation commenced litigation in the B.C. Supreme Court against the Province of British Columbia, Western and the Federal Government of Canada seeking, amongst other things, orders to set aside the Province's decision to remove Western's private lands from a TFL and the Province's approval of the Company's Forest Stewardship Plan on the Crown lands within their area of interest, based on alleged infringements of their treaty rights and unextinguished aboriginal title and rights. A preliminary application by the Province to restrict the scope of this litigation had been scheduled for January, 2010 but was adjourned at the request of the Kwakiutl First Nation. No new hearing dates have been set for that application and the matter is in abeyance.

In 2005 the Hupacasath First Nation obtained an order of the B.C. Supreme Court requiring the Province of British Columbia to consult with them regarding certain Crown decisions, including a 2004 decision of the Minister of Forests, Mines and Lands to remove private lands from TFL 44, a TFL subsequently acquired by the Company. In the third quarter of 2008 the Court ordered that a mediator be appointed to address appropriate accommodation for the effects of the Minister's 2004 private land decision upon the asserted aboriginal rights of the Hupacasath First Nation on their claimed territory, both with respect to the private lands that are now outside the TFL and the Crown lands that remain within the Company's TFL. The scope of this mediation is to include, among other

things, consideration of possible accommodation from resources on the Crown lands remaining in the TFL now held by the Company. No result of this mediation has been announced.

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

In August 2009, the British Columbia Court of Appeal upheld an earlier Forest Appeals Commission decision that had confirmed the Company was entitled to calculate stumpage at one of its operations in a manner that would result in a rebate to the Company of stumpage previously paid. The Province application for leave to appeal this decision to the Supreme Court of Canada was denied on March 11, 2010. The Company is now entitled to a rebate of stumpage previously paid in this matter. Other pending stumpage appeals, held in abeyance pending the outcome of these legal proceedings, are now proceeding to hearing before the British Columbia Forest Appeals Commission and the potential stumpage rebate is not possible to ascertain at this time

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

Reliance on Directors, Management and Other Key Personnel

Western relies upon the experience and expertise of our personnel. No assurance can be given that we will be able to retain our current personnel and attract additional personnel as necessary for the development and operation of our business. Loss of or failure to attract and retain key personnel could have a material adverse effect on Western's business.

Change of Control of Western

BSSML currently holds 49% of the outstanding Common Shares of Western and its additional equity interest in Western through Non-Voting Shares. If a change of control of Western were to occur, there could be significant adverse consequences to Western. If it is determined that there has been an acquisition of control for Canadian tax purposes we may lose the benefit of historical tax losses, which may limit our ability to shelter future operating income from tax. In addition, if BSSML or any person were to acquire sufficient Common Shares to constitute a change or acquisition of control of Western, and the Minister of Forests, Mines and Lands were to be satisfied the change or acquisition of control unduly restricted competition in standing timber, log or wood chip markets, the Minister could make a determination to cancel all or a part of our Forest Act tenures. If this were to occur, we may have to obtain the fibre to run the combined business facilities from external sources, perhaps at a higher cost. A significant increase in our costs could have a material adverse effect on the financial condition and results of operations of the combined business.

Certain Voting Rights of the Non-Voting Shares

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

Evaluation of Disclosure Controls and Procedures

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, Western carried out an evaluation of the design and effectiveness of the Company's disclosure controls and procedures and internal controls over financial reporting as of December 31, 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 annual filings are being prepared. In addition, Western's CEO and CFO concluded that the Company's internal controls over financial reporting are effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for Western and its consolidated subsidiaries for the period in which the annual filings are being prepared.

The CEO and CFO confirm that there were no changes in the controls which materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting during the last quarter of 2010.

Outstanding Share Data

As of February 23, 2011 there were 128,625,623 Common Shares and 338,945,860 Non-Voting Shares issued and outstanding. 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 Company's incentive stock option plan. During 2010, 4,000,000 options were granted, 4,324,000 options were cancelled and no options were exercised. As of February 23, 2011, 4,741,795 options were outstanding under the Company's incentive stock option plan.

Management's Discussion and Analysis – Appendix A

Summary of Selected Results for the Last Eight Quarters

(millions of dollars except per share amounts and where noted)	2010					2009				
	Year	4 th	3 rd	2 nd	1 st	Year	4 th	3 rd	2 nd	1 st
Average Exchange Rate – Cdn \$ to purchase one US \$	1.030	1.013	1.039	1.029	1.040	1.140	1.056	1.098	1.167	1.244
Sales										
Lumber	475.1	118.1	123.7	131.1	102.2	438.2	96.3	111.8	101.9	128.2
Logs	139.0	38.8	39.1	36.6	24.5	99.6	32.5	25.5	25.3	16.3
By-products	53.8	15.7	12.7	13.8	11.6	42.7	10.5	12.6	11.5	8.1
Total sales	667.9	172.6	175.5	181.5	138.3	580.5	139.3	149.9	138.7	152.6
Lumber										
Shipments – millions of board feet	669	168	165	189	147	608	140	157	145	166
Price – per thousand board feet	710	703	750	694	695	721	688	712	703	772
Logs										
Shipments – thousands of cubic meters	2,342	646	642	640	414	1,594	528	413	406	247
Price – per cubic metre	59	60	61	57	59	62	62	62	62	66
Selling and administration	24.5	7.6	5.8	5.7	5.4	24.7	5.6	5.8	5.9	7.4
EBITDA	47.7	7.1	11.7	20.9	8.0	(34.8)	2.3	(5.2)	(16.0)	(15.9)
Amortization of capital assets	(28.8)	(6.6)	(6.7)	(8.1)	(7.4)	(29.5)	(7.2)	(7.3)	(8.2)	(6.8)
Operating restructuring items	(1.6)	(0.1)	(0.6)	(0.9)	-	(5.5)	0.3	(2.3)	(3.5)	-
Net interest expense	(12.4)	(2.6)	(3.4)	(3.3)	(3.1)	(10.8)	(3.2)	(2.9)	(2.3)	(2.4)
Other income (expense)	24.3	5.9	6.3	1.5	10.6	7.4	5.1	1.7	0.5	0.1
Income taxes	-	0.6	(0.1)	(0.3)	(0.2)	(0.1)	-	(0.1)	-	-
Net income (loss) from continuing operations	29.2	4.3	7.2	9.8	7.9	(73.3)	(2.7)	(16.1)	(29.5)	(25.0)
Net loss from discontinued operations	(1.5)	(0.3)	(0.3)	(0.3)	(0.6)	(2.0)	(0.4)	(0.5)	(0.6)	(0.5)
Net income (loss)	27.7	4.0	6.9	9.5	7.3	(75.3)	(3.1)	(16.6)	(30.1)	(25.5)
EBITDA as % of sales	7.1%	4.1%	6.7%	11.5%	5.8%	(6.0)%	1.7%	(3.5)%	(11.5)%	(10.4)%
Earnings per share:										
Net income (loss) basic and diluted	0.06	0.01	0.01	0.02	0.02	(0.17)	(0.01)	(0.04)	(0.06)	(0.06)
Net income (loss) from continuing operations basic and diluted	0.06	0.01	0.02	0.02	0.02	(0.16)	(0.01)	(0.04)	(0.06)	(0.06)

In a normal operating year there is some seasonality to the Company's operations with higher lumber sales in the second and third quarters when construction activity, particularly in the United States, has historically tended to be higher. However, in 2009 the unusual economic circumstances caused this pattern to be overridden. 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 (expense)" comprises net gains on the sale of various assets and other receipts which can be unpredictable in their timing. More material transactions of this nature occurred in the fourth quarter of 2009 and in the first, third and fourth quarters of 2010. Throughout 2009, in particular, results suffered from the significant downturn in the forest products industry, bringing associated production curtailments. The second and third quarters of 2009 and the second, third and fourth quarter of 2010 included charges for restructuring.

Western Forest Products Inc.

Consolidated Financial Statements
(Expressed in Canadian dollars)

Years ended December 31, 2010 and 2009

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Western Forest Products Inc. ("Western" or the "Company") is responsible for the accompanying Consolidated Financial Statements and all other information in the Management's Discussion and Analysis. The financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles and, where necessary, reflect Management's best estimates and judgments at this time. The financial information presented throughout the Management's Discussion and Analysis and the Company's press release dated February 23, 2011 is consistent with that contained in the Consolidated Financial Statements.

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

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

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



Dominic Gammiero
Chairman & Chief Executive Officer



Brian Cairo
Chief Financial Officer

February 23, 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Western Forest Products Inc.

We have audited the accompanying consolidated financial statements of Western Forest Products Inc. ("the Company"), which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, comprehensive income (loss) and deficit, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Western Forest Products Inc. as at December 31, 2010 and 2009, and the results of its consolidated operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
Vancouver, Canada

February 23, 2011

Western Forest Products Inc.

Consolidated Balance Sheets

(Expressed in millions of Canadian dollars)

	As at December 31,	
	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 5.1	\$ 8.1
Accounts receivable	58.7	39.7
Inventory ^(Note 4)	128.9	107.6
Prepaid expenses and other assets	4.8	3.8
	<u>197.5</u>	<u>159.2</u>
Property, plant and equipment ^(Note 5)	375.8	405.9
Other assets ^(Note 6)	13.8	10.9
	<u>587.1</u>	<u>576.0</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Revolving credit facility ^(Note 7)	\$ -	\$ 15.3
Accounts payable and accrued liabilities	73.0	55.2
Current portion of long-term debt ^(Note 8)	-	45.2
Discontinued operations ^(Note 21)	6.2	6.1
	<u>79.2</u>	<u>121.8</u>
Long-term debt ^(Note 8)	104.9	74.5
Other liabilities ^(Note 10)	29.5	29.8
Deferred revenue ^{(Notes 2(g) and 14(d))}	70.4	72.4
	<u>284.0</u>	<u>298.5</u>
Shareholders' equity:		
Common shares ^(Note 12)	412.3	412.3
Non-voting shares ^(Note 12)	187.5	187.5
Contributed surplus	2.8	2.5
Deficit	(299.5)	(324.8)
	<u>303.1</u>	<u>277.5</u>
Commitments and contingencies ^(Note 14)		
Subsequent events ^{(Notes 14(a) and 23)}		
	<u>587.1</u>	<u>576.0</u>

See accompanying notes to these consolidated financial statements

Approved on behalf of the Board:



Dominic Gammiero, Chairman & CEO



Lee Doney, Vice Chairman

Western Forest Products Inc.

Consolidated Statements of Operations, Comprehensive Income (Loss) and Deficit

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

	Year ended December 31,	
	2010	2009
Sales	\$ 667.9	\$ 580.5
Cost and expenses:		
Cost of goods sold	554.4	555.1
Export tax	3.9	6.0
Freight	66.2	59.0
Selling and administration	24.5	24.7
	<u>649.0</u>	<u>644.8</u>
Operating income (loss) before operating restructuring items	18.9	(64.3)
Operating restructuring items ^(Note 18)	(1.6)	(5.5)
Operating income (loss)	17.3	(69.8)
Net interest expense ^(Note 19)	(12.4)	(10.8)
Other income ^(Note 20)	24.3	7.4
	<u>29.2</u>	<u>(73.2)</u>
Income (loss) before income taxes	29.2	(73.2)
Income tax expense ^(Note 9)	-	(0.1)
	<u>29.2</u>	<u>(73.3)</u>
Net income (loss) from continuing operations	29.2	(73.3)
Net income (loss) from discontinued operations ^(Note 21)	(1.5)	(2.0)
	<u>27.7</u>	<u>(75.3)</u>
Net income (loss) and comprehensive income (loss)	27.7	(75.3)
Deficit, beginning of year	(324.8)	(249.5)
Change in accounting policy ^(Note 3)	(2.4)	-
Deficit, beginning of year as adjusted	<u>(327.2)</u>	<u>(249.5)</u>
Deficit, end of year	<u>\$ (299.5)</u>	<u>\$ (324.8)</u>
Income (loss) per share <i>(in dollars)</i> : ^{(Note 12(e))}		
Basic and diluted income (loss) per share	\$ 0.06	\$ (0.17)
Basic and diluted income (loss) per share from continuing operations	<u>\$ 0.06</u>	<u>\$ (0.16)</u>
Weighted average number of shares outstanding (thousands)		
Basic	467,571	452,431
Diluted	474,778	452,431

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.

Consolidated Statements of Cash Flows

(Expressed in millions of Canadian dollars)

	Year ended December 31,	
	2010	2009
Cash provided by (used in):		
Operating activities:		
Net income (loss) from continuing operations	\$ 29.2	\$ (73.3)
Items not involving cash:		
Amortization of capital assets ^(Note 5)	28.8	29.5
Gain on disposal of property, plant and equipment	(7.2)	(3.5)
Other	0.3	(3.5)
	<u>51.1</u>	<u>(50.8)</u>
Changes in non-cash working capital items:		
Accounts receivable	(15.7)	5.9
Inventory	(23.7)	121.2
Prepaid expenses	(1.0)	4.4
Accounts payable and accrued liabilities	17.8	(17.5)
	<u>28.5</u>	<u>63.2</u>
Investing activities:		
Additions to property, plant and equipment	(11.6)	(8.9)
Proceeds from disposal of property, plant and equipment	15.3	7.0
	<u>3.7</u>	<u>(1.9)</u>
Financing activities:		
Changes in revolving credit facility	(15.3)	(93.6)
Proceeds from Rights Offering, net of costs ^(Note 12)	-	49.6
Repayment of long-term debt	(16.1)	(6.4)
Refinancing fees	(2.3)	(3.2)
	<u>(33.7)</u>	<u>(53.6)</u>
Cash provided by (used in) continuing operations	(1.5)	7.7
Cash used in discontinued operations ^(Note 21)	(1.5)	(3.1)
Increase (decrease) in cash and cash equivalents	(3.0)	4.6
Cash and cash equivalents, beginning of year	8.1	3.5
Cash and cash equivalents, end of year	<u>\$ 5.1</u>	<u>\$ 8.1</u>
Supplementary information:		
Cash interest paid	\$ 9.6	\$ 9.2
Cash income taxes paid	\$ 0.2	\$ 0.3

See accompanying notes to these consolidated financial statements

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

1. Nature of Operations:

The business of Western Forest Products Inc. (the "Company" or "Western") is timber harvesting and lumber manufacturing for worldwide markets. Western's operations are located in the Coastal region of British Columbia.

2. Significant accounting policies:

The significant accounting policies are summarized below:

(a) Basis of presentation:

These consolidated financial statements have been prepared on a going concern basis in accordance with Canadian generally accepted accounting principles ("GAAP"). The going concern basis of presentation assumes the Company will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. Since December 31, 2009, the Company has generated cash flow from operations of \$28.5 million, reduced its obligations under the revolving credit facility and long term debt by \$31.4 million and renegotiated and extended its revolving credit facility and long-term debt (Notes 7 and 8). The Company has forecasted financial results and cash flows for 2011. These forecasts are based on Management's best estimates of operating conditions, revenues and expenses in the context of the current economic climate, including the continued relatively challenging state of the forest products industry. Some of the major assumptions in the Company's forecast relate to sales volumes and product mix, lumber prices, log and chip prices and the US dollar and Japanese Yen exchange rates. Other significant assumptions include production rates, the useful life of the assets, stumpage rates and the amount of the export tax on lumber shipped to the US. Based on its financial position at December 31, 2010 and its current forecasts, the Company expects it will be able to continue to operate as a going concern for the foreseeable future.

(b) Principles of consolidation:

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries since their respective acquisition dates. The principal wholly-owned operating subsidiaries of the Company at December 31, 2010 are Western Lumber Sales Limited (which sells into the United States), 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). All intercompany balances and transactions have been eliminated on consolidation.

(c) Use of estimates:

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant areas requiring the use of management estimates include inventory valuations, amortization rates, outcome of arbitrations and legal proceedings, restructuring, reforestation liabilities, asset retirement obligations, employee future benefits, and asset impairment provisions. Actual results may differ materially from those estimates.

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

2. Significant accounting policies (continued):

(d) 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.

(e) Inventory:

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 grade (hemlock and balsam, douglas fir and cedar);

(ii) Logs by gross sort.

On January 1, 2010, the Company changed its accounting policy for the costing of lumber inventories from the distributed cost method to the average cost of production method (Note 3). Under the new policy, 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. This compares to the former policy, which allocated costs based on the estimated fair value of the lumber products manufactured. Management believes that this change in accounting policy provides more reliable and relevant information to the users of the financial statements as it is more consistent with industry accounting practices, aligns with the Company's new profit centre strategy, and also results in a more conservative carrying value relative to the previous method used.

Costs for logs produced are allocated to logs based on their 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. 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.

(f) Property, plant and equipment:

Property, plant and equipment is initially recorded at cost and is subsequently amortized on a straight line basis over the expected useful life of the underlying asset (5 to 20 years). Logging roads are amortized over their expected useful life or over the volume anticipated to be accessed by the road.

The cost of major forest tenures is capitalized and subsequently amortized on a straight-line basis over 40 years. The cost of private timberlands is capitalized and is not amortized, as the Company manages its private timberlands on a sustainable yield basis.

(g) Deferred revenue:

Deferred revenue is the result of the contractual obligations incurred upon the acquisition of the Englewood Logging Operation 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 income on a straight-line basis over 40 years, being the term of the related fibre supply contract.

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

2. Significant accounting policies (continued):

(h) Impairment of property, plant and equipment:

The Company conducts reviews for the impairment of property, plant and equipment, including logging roads, and timberlands, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss would be recognized when estimates of future undiscounted cash flows expected to result from the use of an asset and its eventual disposition are less than its carrying amount. An impairment loss would be measured based on the difference between the carrying amount and fair value of the impaired assets.

Due to continued concern about the current global economic situation and the uncertainties with respect to the US lumber market the Company conducted an impairment review of its long-lived assets as at December 31, 2010. Key assumptions in performing this review include sales volumes and product mix, lumber prices, log and chip prices and the US dollar and Japanese Yen exchange rates. Other significant assumptions include production rates, the useful life of the assets, stumpage rates and the amount of the export tax on lumber shipped to the US. In determining the appropriate assumptions the Company has analyzed external data and sought advice from external advisors. Based on the key assumptions used, the projected undiscounted cash flows from operations exceed the carrying value of the Company's long-lived assets.

(i) Foreign currency translation:

Transactions denominated in foreign currencies have been translated into Canadian dollars at the rate of exchange prevailing at the time of the transaction. Monetary assets and liabilities have been translated into Canadian dollars at the period-end exchange rates. Non-monetary assets and liabilities are translated at the exchange rates in effect when the assets were acquired or the liabilities incurred. All exchange gains and losses are included directly in income.

(j) Asset retirement obligation:

The Company recognizes asset retirement obligations at fair value in the period in which the legal obligation is incurred, with the fair value of the liability determined with reference to the present value of estimated future cash flows. In periods subsequent to the initial measurement, changes in the liability resulting from the passage of time and revisions to estimated future cost are recognized in the statement of operations as they occur. The Company's asset retirement obligations relate to the obligation for reforestation on Crown land and certain environmental remediation. Reforestation obligations arise as timber is harvested with the related expenses recognized in the statement of operations as they occur. Reforestation on private timberlands is expensed as incurred.

(k) Revenue recognition:

Sales are recognized when the significant risks and rewards of ownership are passed to the customer. 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

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

2. Significant accounting policies (continued):

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.

(l) Stock-based compensation:

The Company has established a stock-based compensation plan for eligible directors, officers and employees and accounts for it using the fair value method.

Under this method, 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 stock, 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 stock. The Company bases its estimates of volatility on historical stock 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.

(m) Income taxes:

The Company uses the asset and liability method of accounting for future income taxes. Under the asset and liability method, future income tax assets and liabilities are determined based on temporary differences (differences between the accounting bases and the tax bases of existing assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

(n) Employee future benefits:

The Company has various defined benefit and defined contribution plans that provide pension 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.

The Company accrues the costs and related obligations of the defined benefit pension and other retirement benefit plans using the projected benefit actuarial method prorated on service and management's best estimates of expected plan investment performance, salary escalation, and other

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

2. Significant accounting policies (continued):

relevant factors. For the purpose of calculating the expected return on plan assets, the fair value of plan assets is used. Actuarial gains (losses) arise from the difference between the actual and expected long-term rates of return on plan assets for a period or from changes in actuarial assumptions used to determine the accrued benefit obligation. 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 is amortized over the average remaining service period of the active employees, which ranges between 13 and 16 years for both pension and other benefit plans. Past service costs arising from plan amendments are deferred and amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan.

For hourly employees covered by forest industry union defined benefit pension plans, income is charged with the Company's contribution as required under the collective agreements.

The Company accrues the costs and related obligations for defined contribution plans based on the required Company contributions in the period.

(o) 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 the Company's Consolidated Statement of Operations (Note 17).

3. Changes to accounting policies

Adopted in 2010

In 2010, the Company changed its accounting policy for the costing of its lumber inventories (Note 2(e)). This change in accounting policy, which was implemented effective January 1, 2010 on a retrospective basis without restatement of prior periods, resulted in inventory reducing by \$2.4 million to \$105.2 million from \$107.6 million and the deficit increasing to \$327.2 million from \$324.8 million as at January 1, 2010. Prior periods have not been restated as the detailed information required to implement the new policy on a retrospective basis is not available.

Future Changes:

International Financial Reporting Standards ("IFRS"):

In February 2008, the Canadian Accounting Standards Board confirmed that GAAP will be converged with International Financial Reporting Standards ("IFRS") and IFRS will become the new primary source of GAAP for fiscal years commencing January 1, 2011. The transition to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

3. Changes to accounting policies (continued):

financial information using IFRS. While IFRS uses a conceptual framework similar to GAAP, there are significant differences on recognition, measurement, and disclosures.

Western has identified those areas which will be impacted by changes in accounting policy and made policy elections where they are required to be made either specifically at the transition date or on a prospective basis. The areas that are most impacted for Western are: property, plant, and equipment; impairment of assets; intangible assets; private timberlands; and employee future benefits.

Management is finalizing the determination of the impact of the application of IFRS on the financial statements and having these impacts audited.

4. Inventory:

The following table summarizes the value of inventory on hand:

	<u>2010</u>	<u>2009</u>
Log inventory	\$ 79.2	\$ 67.3
Lumber inventory	43.6	31.7
Supplies and other inventories	10.7	10.2
Provision for write downs	<u>(4.6)</u>	<u>(1.6)</u>
Total inventory	<u>\$ 128.9</u>	<u>\$ 107.6</u>

The Company's eligible inventory is pledged as security against the revolving credit facility and long-term debt. At December 31, 2010 \$22.4 million (2009 - \$19.3 million) of the \$128.9 million (2009 - \$107.6 million) of total inventory was carried at net realizable value. During 2010, \$554.4 million (2009 - \$555.1 million) of inventory was charged to cost of sales which includes an increase to the provision for write-down to net realizable value of \$3.0 million.

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

5. Property, plant and equipment:

<u>2010</u>	Cost	Accumulated Amortization	Net book value
Land	\$ 27.2	\$ -	\$ 27.2
Timberlands	276.3	26.4	249.9
Logging Roads	115.1	76.9	38.2
Buildings and equipment	145.6	85.1	60.5
	<u>\$ 564.2</u>	<u>\$ 188.4</u>	<u>\$ 375.8</u>

<u>2009</u>	Cost	Accumulated Amortization	Net book value
Land	\$ 31.6	\$ -	\$ 31.6
Timberlands	283.2	21.7	261.5
Logging Roads	107.6	67.0	40.6
Buildings and equipment	144.1	71.9	72.2
	<u>\$ 566.5</u>	<u>\$ 160.6</u>	<u>\$ 405.9</u>

Amortization of property, plant and equipment

	<u>2010</u>	<u>2009</u>
Amortization of buildings and equipment	\$ 13.9	\$ 15.4
Amortization of timberlands and logging roads	14.9	14.1
	<u>\$ 28.8</u>	<u>\$ 29.5</u>

Included within Timberlands is \$13.6 million of private timberlands that is not subject to depletion.

6. Other assets:

	<u>2010</u>	<u>2009</u>
Investments	\$ 7.4	\$ 7.1
Discontinued operations (Equipment)	2.3	2.2
Other	4.1	1.6
	<u>\$ 13.8</u>	<u>\$ 10.9</u>

7. Revolving credit facility:

On December 14, 2010, the Company completed amendments to its revolving credit facility, improving overall availability and extending the maturity date to December 14, 2015, subject to any future refinancing requirements of its revolving and non-revolving term loans. The facility also provides for successive one year extension periods of the maturity date, subject to lender approval.

The facility provides for a maximum borrowing amount of \$125.0 million, subject to a borrowing base which is primarily based on eligible accounts receivable and inventory balances. The facility bears interest, at Canadian prime plus 0.50% (if availability exceeds \$40.0 million) or 0.75% (if availability is less than \$40.0

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

7. Revolving credit facility (continued):

million) or at the Company's option, at rates for Bankers' Acceptances or LIBOR based loans plus 2.25% or 2.50%, dependent on the same availability criteria. The facility is secured by a first lien interest over accounts receivable and inventory and includes customary financial covenants (Note 13). The Company was in compliance with its covenants at December 31, 2010. Transaction costs of \$1.0 million were incurred with respect to the refinancing of this facility. These costs are deferred and included in Other Assets in the balance sheet and are being amortized into interest expense over the term of the facility.

At December 31, 2010, \$nil was outstanding under this facility (December 31, 2009 - \$15.3 million) and \$79.5 million was unused and available to the Company.

8. Long-term debt:

	2010	2009
Canadian dollar debt		
Revolving term loan	\$ 75.0	\$ 75.0
Non-revolving term loan	31.2	47.3
	<u>106.2</u>	<u>122.3</u>
Associated transaction costs	(1.3)	(2.6)
	104.9	119.7
Less current portion	-	45.2
	<u>\$ 104.9</u>	<u>\$ 74.5</u>

On December 14, 2010, the Company completed amendments to its term loans, extending the maturity date of its \$75.0 million revolving term loan and \$31.2 million non-revolving term loan to June 14, 2013 and December 14, 2012, respectively. All other terms and conditions of the term loans remained substantially unchanged. During 2010 the non-revolving term loan had been paid down by \$16.1 million, largely from the proceeds of non-core asset sales (2009 - \$6.4 million).

The term loans bear interest at margins based on a leverage ratio, calculated as the ratio of total debt to the last twelve month's EBITDA. The Company has the option to base the interest rate at Canadian prime plus a grid-based margin, ranging from 2.75% to 5.0% depending on the leverage ratio, or at rates for Bankers' Acceptances based loans plus a grid-based margin ranging from 3.75% to 6.0% also dependent on the leverage ratio. The term loans are secured by a first lien interest over all of the Company's properties and assets except the Englewood Logging Division, over which it has second lien interest, and excluding all accounts receivable and inventory, and include financial covenants (Note 13) and repayment requirements from the proceeds of asset sales and other non-operating cash inflows. The Company was in compliance with its covenants at December 31, 2010. The interest rates for the revolving and non-revolving term loans were 6.03% and 6.75%, respectively, at December 31, 2010.

The \$1.3 million of transaction costs relate to the new financing arrangements. These costs are deferred and are being amortized into interest expense over the term of the term loan using the effective interest rate method. Deferred transaction costs associated with the previous facilities have been fully expensed.

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

9. Income Taxes:

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

	<u>2010</u>	<u>Tax rate</u>	<u>2009</u>	<u>Tax rate</u>
Income (loss) before income taxes	\$ 29.2		\$ (73.2)	
Expected income tax (expense) recovery	\$ (8.3)	(28.5)%	\$ 22.0	30.0%
Tax effect of:				
Change in valuation allowance	4.4	15.1%	142.2	194.3%
Reorganization of WFP Forest Products Ltd. ("WFPFPL") ^(Note 22)	-	-	(163.7)	(223.6)%
Future tax rate changes	1.5	5.1%	(6.7)	(9.2)%
Change in prior year estimated values	(1.6)	(5.5)%	2.6	3.6%
Other permanent differences	4.0	13.7%	3.5	4.8%
Income tax expense per financial statements	\$ -	-	\$ (0.1)	(0.1)%

	<u>2010</u>	<u>2009</u>
Future tax assets:		
Losses carried forward	\$ 107.8	\$ 109.1
Reforestation and other accruals not deductible for tax until paid	10.7	10.5
	<u>118.5</u>	<u>119.6</u>
Valuation allowance	(92.4)	(96.8)
	<u>26.1</u>	<u>22.8</u>
Future tax liabilities:		
Property, plant and equipment due to differences in net book value and unamortized capital cost	(26.1)	(22.8)
Net future tax liability	<u>\$ -</u>	<u>\$ -</u>

At December 31, 2010, the Company and its subsidiaries have unused tax losses carried forward estimated at \$420.0 million (2009 - \$434.3 million), that expire between 2015 and 2030, available to reduce taxable income and capital losses of \$22.5 million (2009 - \$4.0 million) available to be utilized against capital gains. The ability of the Company to utilize the losses carried forward and capital losses is not considered "more likely than not" and therefore, a valuation allowance has been provided against the tax assets.

Western Forest Products Inc.

Notes to Consolidated Financial Statements

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

Years ended December 31, 2010 and 2009

10. Other liabilities:

	<u>2010</u>	<u>2009</u>
Pension liability ^(Note 16)	\$ 12.6	\$ 13.5
Environmental accruals	1.5	1.5
Long-term portion of reforestation liability ^(Note 11)	14.7	14.4
Other	0.7	0.4
	<u>\$ 29.5</u>	<u>\$ 29.8</u>

11. Reforestation liability:

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

	<u>2010</u>	<u>2009</u>
Reforestation liability, beginning of period	\$ 24.7	\$ 26.8
Reforestation provision charged	10.9	7.0
Reforestation work payments	(9.5)	(9.1)
	<u>\$ 26.1</u>	<u>\$ 24.7</u>
Consisting of:		
Long-term portion included in other liabilities	\$ 14.7	\$ 14.4
Current portion included in accounts payable and accrued liabilities	11.4	10.3
	<u>\$ 26.1</u>	<u>\$ 24.7</u>

The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at December 31, 2010 is \$29.9 million (2009 - \$28.2 million). The reforestation expenditures are expected to occur over the next one to ten years and have been discounted at the Company's credit-adjusted risk-free rates of 3.7% to 6.2%. Reforestation expense incurred on current production and accretion expense are included in production costs for the year.

12. Share capital:

(a) Authorized and issued 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. The Common Shares entitle the holders thereof to one vote per share. The Non-

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12. Share capital (continued):

(a) Authorized and issued share capital (continued):

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

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

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

	Number of Common Shares		Amount	Number of Non-Voting Shares		Amount
December 31, 2010 and 2009	128,625,623	\$ 412.3		338,945,860	\$ 187.5	

(b) Rights offering:

On January 22, 2009, the Company raised a total of \$50.0 million before expenses through a rights offering to all shareholders pursuant to a final short-form prospectus dated December 10, 2008. Western used the \$49.6 million net proceeds of the Rights Offering to reduce indebtedness under its revolving line of credit, thereby providing additional liquidity. Under the terms of the rights offering, common and non-voting shareholders received one right for each Common Share or Non-Voting Share that enabled them to subscribe for 1.28737 Common Shares of the Company at a price of \$0.19 per Common share. The rights were listed for trading on the Toronto Stock Exchange ("TSX") and were exercisable until January 20, 2009.

Brookfield Special Situations Management Limited ("BSSML") subscribed for Common Shares under both the basic subscription privilege and the additional subscription privilege. In accordance with the terms of a prior agreement, the Company only permitted the exercise of that portion of the rights owned by BSSML that resulted in BSSML beneficially owning, or exercising control or direction over, not more than 49% of the Common Shares outstanding. Accordingly, the Company only allowed the conversion of rights for the issuance of 4,303,788 Common Shares to BSSML with the remaining rights converted into 254,374,654 Non-Voting Shares. As a result, BSSML holds 63,026,544 Common Shares, or 49% of the Company's 128,625,623 Common Shares and 100% of the 338,945,860 Non-Voting Shares now issued and outstanding.

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12. Share capital (continued):

(c) Stock-based compensation plan:

The Company has an incentive stock option plan (the "Option Plan"), which permits the granting of options to eligible participants to purchase up to an aggregate of 10,000,000 Common Shares. During 2010, the Company recorded compensation expense of \$0.3 million (2009 - \$0.3 million) which has been credited to contributed surplus. Each option is exercisable, subject to vesting terms of 20% per year and immediately upon a change in control of the Company, into one Common Share, subject to adjustments, at a price of not less than the closing price of the Common Shares on the TSX on the day immediately preceding the grant date. Options granted under the Option Plan expire, generally, a maximum of ten years from the date of the grant.

During the year, the Company granted 4,000,000 options with a fair value of \$0.4 million as determined by the Hull-White option pricing model using the assumptions of a weighted average exercise price of \$0.22, risk free interest rate of 3.42%, volatility of 41% and an expected life of 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. With the additional requirement for the share price to exceed a certain level before the options become exercisable it was necessary to utilize the Hull-White model as the Black-Scholes model used for valuing earlier granted options was no longer applicable. All other options outstanding that were previously granted do not contain the minimum price requirement and continue to be valued under the Black-Scholes model. Also during the year, 4,324,000 options were cancelled.

The following table summarizes the change in the options outstanding during the years ending December 31, 2010 and 2009:

	<u>2010</u>		<u>2009</u>	
	Number of	Weighted	Number of	Weighted
	<u>options</u>	<u>average</u>	<u>options</u>	<u>average</u>
		<u>exercise price</u>		<u>exercise price</u>
Outstanding, beginning of year	5,065,795	\$0.76	4,288,060	\$2.10
Granted	4,000,000	0.22	3,500,000	0.25
Cancelled	(4,324,000)	0.34	(2,722,265)	2.21
Outstanding, end of year	<u>4,741,795</u>	<u>\$0.68</u>	<u>5,065,795</u>	<u>\$0.76</u>

Details of options outstanding under the share option plan at December 31, 2010 are as follows:

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12. Share capital (continued):

(d) Class C Warrants:

During 2009, the Company had 2,847,262 Class C non-transferrable Warrants outstanding with exercise prices ranging from \$14.11 to \$29.32 per warrant. On July 28, 2009 these warrants expired with all but 23 of the 2,847,262 outstanding warrants being unexercised. Due to their contingent nature, the warrants had no value allocated to them for accounting purposes.

(e) Income (loss) per share:

Basic income (loss) per share was calculated by dividing the net income (loss) by the weighted average number of shares issued and outstanding over the period. Diluted net income (loss) per share was calculated by reference to the fully diluted weighted average number of shares outstanding as determined using the treasury stock method and considering the dilutive effect, if any, of employee stock options (Note 12(c)) and Class C Warrants (Note 12(d)). For the year ending December 31, 2009 these options and warrants were anti-dilutive.

13. Capital requirements:

The Company's strategy for managing capital is to maintain a capital position that provides financial flexibility and achieves growth with the objective of maximizing long-term shareholder value. Western's capital requirements typically include major new investments designed to increase net income and disbursements for other new equipment and ongoing enhancements, efficiency improvements, safety, and protection or extension of the life of equipment. Finally, significant expenditures are also required to fund new capital roads allowing access to timber stands for harvesting purposes. During 2010, significant capital expenditures have again been curtailed because of the current economic climate and expenditures have been limited to only essential road and bridge construction.

The Company seeks to achieve a balance between the higher returns that may arise with higher levels of borrowing and the advantages and security provided by a sound capital position. The Company monitors the ratio of net debt to capitalization, targeting a ratio in the range of 30% to 45%. Net debt is defined as long-term debt plus amounts drawn on the revolving credit facility, less cash and cash equivalents. Capitalization comprises net debt and shareholders' equity.

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

Since originally refinancing its term debt in March of 2008, the Company has repaid a total of \$68.8 million of the term loans substantially from the cash proceeds of disposition of non-core assets (Note 20). Pursuant to the re-financing agreement completed on December 14, 2010 (Note 8), term debt repayments will continue as non-core asset sales are realized.

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13. Capital requirements (continued):

Under the current financing agreements, the Company is subject to financial covenants. The revolving credit facility contains two financial covenants: minimum consolidated adjusted shareholders' equity of \$200.0 million and, should availability fall below \$10.0 million or in the event of default, minimum fixed charge coverage ratio of 1.1:1.0. The term loans contains three financial covenants: (i) maximum capital expenditures of \$55.0 million, measured each fiscal year, to the extent the total term loans outstanding exceed \$75.0 million; (ii) maximum loan to value ratio of 50% (Loans are defined as the total term loans outstanding and value is defined as the appraised value of our crown tenures and private timberlands. This financial covenant is measured on the last day of each fiscal year and at the time of consummation of a sale or disposition of assets, with certain exceptions); and (iii) maximum funded debt to capitalization of 0.45 to 1.0, measured on a quarterly basis. As at December 31, 2010, the Company is in compliance with all financial covenants, and expects to be in compliance for the next 12 months.

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

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

14. Commitments and contingencies:

(a) Lumber duties and export tax:

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

The export tax only applies to the first US\$500 per thousand board feet for any product sales. In addition, if the monthly volume of exports from the British Columbia coastal region exceeds a certain "Trigger Volume" as defined in the SLA, a "surge" mechanism will apply to increase the rate of the export tax for that month by 50% (for example, the 15% export tax rate would become 22.5% for that month). For the year to December 31, 2010 Company recorded an expense of \$3.9 million (2009 - \$6.0 million) which reflects the fact that throughout 2009 the export tax rate was at the maximum rate whereas in 2010 the rate was at a reduced level during May, June and July, 2010 as the result of a spike in the price of lumber.

On October 8, 2010, the United States Trade Representative wrote to Canada's International Trade Minister to request consultations under the SLA with respect to allegations of under-pricing of timber in the British Columbia interior and circumvention of export measures provided for in the SLA. On January 18, 2011, the United States triggered the arbitration provision of the SLA by delivering a Request for

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14. Commitments and contingencies (continued):

Arbitration. As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of British Columbia provincial government and the British Columbia lumber industry. As the claim is specifically directed at British Columbia interior practices, it is not possible at this time to predict any potential direct or indirect impact it may have on Western, which operates predominantly on the coast of British Columbia.

(b) Litigation and claims:

In the normal course of its business activities, the Company may be subject to a number of claims and legal actions that may be made by customers, unions, suppliers and others in respect of which either provision has been made or for which no material liability is expected. The Company has a number of claims filed against it from logging contractors and unions with respect to various operating issues. Certain of the claims are pending mediation or arbitration, while others have not yet reached this formal stage. Where the Company is not able to determine the outcome of these disputes no amounts have been accrued in these financial statements.

(c) Indemnity agreement:

As a result of the amalgamation of the Company with Cascadia Forest Products Ltd. ("Cascadia") in 2006, the Company has assumed Cascadia's obligation to indemnify an entity related to Brookfield Asset Management ("BAM") if that entity incurs liabilities under a guarantee (the "Guarantee") provided by it to a third party relating to the obligations of Cascadia arising out of the purchase by Cascadia of certain of its assets from the third party prior to the acquisition of Cascadia by the Company. The Guarantee is limited to \$100.0 million. As security for its performance under this indemnity and as a result of the amalgamation, the Company has issued a debenture in favour of the related entity in the amount of \$100.0 million which results in a charge over all of the Company's real property and all of the Company's present and after-acquired personal property. In the absence of any claims, the Guarantee terminates on May 30, 2011 and if there is no liability accruing to the guarantor thereunder at that time, the Company may request that the debenture be discharged.

(d) Long-term fibre supply agreements:

The Company has a number of long-term commitments to supply fibre to third parties including a 40 year agreement, entered into on March 17, 2006 ("40 Year Agreement"). As consideration for entering into the 40 Year Agreement the Company received a price premium of \$80.0 million that will be earned as wood chips are delivered under the agreement. Upon execution, a non-refundable prepayment of the price premium of \$35.0 million was received with the balance of \$45.0 million set-off against the consideration due by the Company on its acquisition of the Englewood Logging Division from the same party to the fibre supply agreement. The Company recorded the price premium as deferred revenue (Note 2(g)) and has granted a first charge over the acquired assets (including a tree farm license with an allowable annual cut of 844,000 cubic metres, 4,771 hectares of private timberlands and other capital improvements and equipment) to secure certain of these obligations.

In addition, certain of the fibre supply agreements have minimum volume requirements and may, in the case of a failure to supply the minimum volume, require the Company to source the deficiency from

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14. Commitments and contingencies (continued):

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. As Western takes 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 contractual obligations without incurring additional cost. The Company has not delivered the annual minimum chip volume for 2010 as required under the 40 Year Agreement and is in discussions with the party to amend the contract, including the minimum chip volumes. At this time the Company is unable to determine if the amendment will be executed, or whether the party to the contract will act on its security.

(e) Operating leases:

Future minimum lease payments at December 31, 2010 under operating leases were as follows:

2011	\$	3.4
2012		2.3
2013		1.5
2014		1.3
2015		1.3
Thereafter		6.9
	\$	<u>16.7</u>

(f) Allowable annual cut reductions:

During 2010 the allowable annual cut ("AAC") of several of the Company's timber tenures was adjusted by the Province of British Columbia ("Province"). The AAC of the Company's Tree Farm Licence ("TFL") 19 was permanently reduced from 833,795 m³ to 717,848 m³ as a result of a periodic timber supply review by the Province's Chief Forester. In addition, a number of the Company's other timber tenures which previously had their AAC temporarily reduced by orders made under Part 13 of the Forestry Revitalization Act (British Columbia) to ensure that harvest rates remained at a sustainable level until land use planning was completed in the affected areas saw those reductions either expire or made permanent. In Haida Gwaii a temporary AAC reduction of 293,000 m³ for TFL 39 (now TFL 60) expired on December 31, 2010. In the Central Coast the combined AACs of Forest Licences ("FL") A16845 and A16847, which had been temporarily reduced by 74,546 m³ under Part 13 orders, saw the Part 13 reduction expire and the combined AACs of these FLs were permanently reduced by 55,245 m³. Similarly, the combined temporary Part 13 AAC reductions of 3,228 m³ in place for FLs A19231 and A19244 expired, but a permanent reduction of 2,536 m³ was imposed for FL 19244. In the case of TFL 44, where a Part 13 designation had been in place without an AAC reduction, the AAC was temporarily reduced by 88,700 m³ and made retroactive to 2007. For Part 13 orders that extend for more than four years from the date of issuance or when the Province's land use planning process results in these reductions becoming permanent, the Company has the ability to seek compensation from the Province for the reduced cutting rights thereafter, subject to certain statutory deductions. Western intends to pursue mitigation or compensation from the Province for the temporary AAC reductions that have now been made permanent.

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14. Commitments and contingencies (continued):

(g) The Forest Revitalization Plan:

In January 2005, pursuant to terms of a settlement framework agreement negotiated in late 2004, the Company received \$16.5 million in compensation from the Province for the loss of 685,216 cubic meters of AAC and 827 hectares of timber licences. During 2010, the Company received an additional compensation payment from the Province for improvements not previously reimbursed of \$5.2 million (2009 - \$ 2.7 million) (Note 20).

(h) 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. Work has commenced to repair the damage with expenditures of \$1.0 million incurred and recognized in the Consolidated Statement of Operations to December 31, 2010. Some areas remain inaccessible, making a reasonable estimate of total damages uncertain. The impact on capitalized roads and bridges and other infrastructure is not expected to be significant. The Company is working with its insurers to quantify the amount of damage resulting from this event.

(i) Pension funding commitments:

The Company is committed to making estimated annual payments in relation to its salaried pension plans of \$2.9 million for each of the next two years and \$2.2 million for each of the following three years, or until such time as a new funding valuation may lead to a change in the amount of payments required.

15. Segmented information:

The Company is an integrated Canadian forest products company operating in one industry segment comprised of timber harvesting, log sales and lumber sales and manufacturing for world-wide markets.

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

	<u>2010</u>	<u>2009</u>
Canada	\$ 281.1	\$ 236.9
United States	70.9	79.2
Asia	269.4	217.2
Europe	32.1	34.5
Other	14.4	12.7
	<u>\$ 667.9</u>	<u>\$ 580.5</u>

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

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16. Employee future benefits:

The Company has several funded and unfunded defined benefit plans, a defined contribution pension plan and a group RRSP that provide retirement benefits to substantially all salaried employees and certain hourly employees. In addition, the Company provides other unfunded retirement and post employment benefits to certain former salaried and hourly employees. The funded and unfunded defined benefit pension plans were closed to new entrants effective June 30, 2006, and effective December 31, 2010 no further benefits accrue under these plans, and members became eligible to participate in the defined contribution plan. All new salaried employees are now provided with pension benefits through a defined contribution plan. The defined benefit plans are based on years of service to December 31, 2010, and final average earnings. The Company's other post-employment benefit plans are non-contributory and include a range of health care and other benefits. Total cash payments for employee future benefits for the year ended December 31, 2010 were \$10.5 million (2009 - \$10.7 million), consisting of cash contributed by the Company to its funded pension plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to the forest industry union defined benefit plans. In relation to defined benefit plans, the Company measures the fair value of plan assets and the accrued benefit obligations for accounting purposes as at December 31 of each year. The most recent actuarial valuations of the funded defined benefit pension plans were at December 31, 2007. The next actuarial valuation for both funded defined benefit plans is being prepared for December 31, 2010, but is not yet available.

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

	Year ended December 31, 2010		Year ended December 31, 2009	
	Salaried pension plans	Non-pension plans	Salaried pension plans	Non-pension plans
Plan assets:				
Fair value, beginning of year	\$ 98.3	\$ -	\$ 89.8	\$ -
Company contributions	2.3	0.5	3.1	0.5
Benefits paid	(8.5)	(0.5)	(9.1)	(0.5)
Actual return on assets	10.0	-	14.5	-
Fair value, end of year	<u>\$ 102.1</u>	<u>\$ -</u>	<u>\$ 98.3</u>	<u>\$ -</u>
Accrued benefit obligation:				
Balance, beginning of year	\$ 105.1	\$ 6.9	\$ 98.2	\$ 6.0
Current service cost	1.4	-	1.7	-
Benefits paid	(8.5)	(0.5)	(9.1)	(0.5)
Interest cost	6.4	0.4	6.8	0.4
Curtailment gain	-	-	(3.1)	-
Actuarial loss (gain)	11.4	0.5	10.6	1.0
Balance, end of year	<u>\$ 115.8</u>	<u>\$ 7.3</u>	<u>\$ 105.1</u>	<u>\$ 6.9</u>
Funded status (end of year):				
Funded status deficit	\$ (13.7)	\$ (7.3)	\$ (6.8)	\$ (6.9)
Unamortized past service costs	-	-	-	-
Unamortized net actuarial loss (gain)	9.9	(1.5)	2.3	(2.1)
Balance sheet liability	<u>\$ (3.8)</u>	<u>\$ (8.8)</u>	<u>\$ (4.5)</u>	<u>\$ (9.0)</u>

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16. Employee future benefits (continued):

Included in the above accrued benefit obligations and plan assets for salaried pension plans are accrued benefit obligations of \$115.8 million (2009 - \$21.7 million) and plan assets of \$102.1 million (2009 - \$13.9 million) in respect of plans with accrued benefit obligations in excess of plan assets.

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

	<u>2010</u>	<u>2009</u>
Equity securities	62%	62%
Debt securities	37%	37%
Other	1%	1%
	<u>100%</u>	<u>100%</u>

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

	<u>2010</u>	<u>2009</u>
Discount rate at beginning of year for:		
Non-pension	6.10%	7.30%
Pension plans	6.24%	7.40%
Discount rate at end of year for:		
Non-pension plans	5.30%	6.10%
Pension plans	5.36%	6.24%
Expected long-term return on assets of pension plans	6.50%	7.00%
Rate of compensation increase for all plans	3.68%	3.50%
Health care cost trend rate	7.0% for 2011 reducing to 4.5% in 2024	7.4% for 2010 reducing to 4.5% in 2022

The following table illustrates the sensitivity of the results for the non-pension plan to a \pm 1% change in the assumed health care cost trend rate assumption:

	1% decrease	base cost	1% increase
Company service cost for 2010	\$ -	\$ -	\$ -
Interest cost for 2010	\$0.4	\$0.4	\$0.5
Accrued benefit obligation as at December 31, 2010	\$6.7	\$7.3	\$8.1

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16. Employee future benefits (continued):

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

	Year ended December 31, 2010		Year ended December 31, 2009	
	Salaried pension plans	Non-pension plans	Salaried pension plans	Non-pension plans
Defined benefit plans:				
Current service cost	\$ 1.4	\$ -	\$ 1.7	\$ -
Interest cost	6.4	0.4	6.8	0.4
Actual return on assets	(10.0)	-	(14.5)	-
Actuarial loss	11.4	0.5	10.6	1.0
Curtailment gain	-	-	(3.1)	-
Difference between actual and expected results:				
Return on plan assets	3.8	-	8.3	-
Actuarial loss	(11.4)	(0.5)	(8.4)	(1.2)
Plan amendments	-	-	0.3	-
Total for defined benefit plans	1.6	0.4	1.7	0.2
Defined contribution plans	1.5	-	1.7	-
Net periodic pension expense	<u>\$ 3.1</u>	<u>\$ 0.4</u>	<u>\$ 3.4</u>	<u>\$ 0.2</u>

During the year ended December 31, 2009, workforce reductions resulted in curtailment accounting for certain of the Company's defined benefit pension plans. The curtailment resulted in a reduction of the accrued benefit obligation of \$3.1 million. This reduction in the obligation was partially offset by the recognition of previously unrecognized actuarial losses and past service costs of \$2.5 million, resulting in a reduction to net periodic pension expense of \$0.6 million.

In addition, unionized employees are members of industry-wide pension plans to which the Company contributes a predetermined amount per hour worked by an employee. The pension expense for these plans is equal to the Company's contributions and for 2010 amounted to \$6.2 million (2009 - \$5.4 million).

17. Financial instruments:

All financial instruments and derivatives are measured at fair value on initial recognition. CICA Handbook Section 3862 *Financial Instruments – Disclosures* requires classification of financial instruments measured at fair value within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

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

Level 3 – Inputs that are not based on observable market data.

Cash and cash equivalents are classified as held-for-trading and measured at fair value based on level 1 inputs. Accounts receivable are classified as loans and receivables and are measured at amortized cost

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17. Financial instruments (continued):

using the effective interest rate method, which approximates the fair value due to the short term to maturity of these instruments.

The Company's financial liabilities comprise accounts payable and accrued liabilities and long-term debt. All financial instrument liabilities are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method.

The carrying value of accounts payable and accrued liabilities included on the Consolidated Balance Sheets approximate their fair value due to the short term to maturity of these instruments.

The carrying value of accrued liabilities for reforestation costs included on the Consolidated Balance Sheets approximates their fair value, as this is determined based on the present value of future cash flows associated with these liabilities.

The Company does not have any financial instruments classified as available-for-sale.

Long-term debt is recorded at the principal amount less the net value of the associated financing fees. Financing fees are deferred and amortized over the life of the debt using the effective interest rate method. The carrying value of drawings on the long-term debt included on the Consolidated Balance Sheets approximate their fair value based on level 2 inputs as they bear floating interest rates that approximate market rates. The Company does not consider the credit risk associated with the counterparty of the long-term debt to be significant.

The Company utilizes financial instruments in the normal course of business and takes action to mitigate the associated risks. Certain of the Company's sales transactions are denominated in foreign currencies, principally, the US dollar and Japanese Yen ("JPY"), and accordingly the Company is exposed to currency risk associated with changes in foreign exchange rates. To assist in mitigating this exchange risk, the Company has entered into an agreement dated March 31, 2009 with BAM to provide a foreign exchange facility ("Facility") to the Company. The Facility, which is for a notional amount of up to US \$80.0 million, matures on March 31, 2011, and allows for forward transactions with a maximum term for each transaction of up to one year. The maturity date is subject to automatic annual renewal subject to BAM notifying the Company of its intention to cancel the facility at least 30 days prior to the anniversary date and to certain change of control provisions being invoked. The Facility is unsecured and is subject to a fee of 0.10% of the notional amount per annum. The Company does not consider the credit risk associated with this Facility to be significant.

During 2010, the Company entered into contracts under the facility to sell US dollars and JPY forward in order to mitigate a portion of this foreign currency risk. At December 31, 2010, the Company had outstanding obligations to sell an aggregate US \$2.1 million at an average exchange rate of CAD \$1.0554 per US dollar with maturities through February 28, 2011, and to sell an aggregate JPY 2,250 million at an average rate of JPY 79.55 per CAD with maturities through June 30, 2011.

All foreign currency gains and losses to December 31, 2010 have been recognized in sales in the Consolidated Statement of Operations and the fair value of these instruments at December 31, 2010 was a net asset of \$0.8 million which is included in accounts receivable on the Consolidated Balance Sheet (there

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17. Financial instruments (continued):

were no forward contracts in place at December 31, 2009). A net gain of \$1.1 million was recognized on contracts which matured during 2010 (2009 - \$3.4 million), which is included in sales in the Consolidated Statement of Operations. An increase (decrease) of 1% in the value of the Canadian dollar as compared to the JPY would result in a gain (loss) of approximately \$0.2 million in relation to the JPY foreign exchange forward contracts held at year end. An increase (decrease) of 1% in the value of the Canadian dollar as compared to the US dollar would have an immaterial impact on US dollar foreign exchange forward contracts held at year end.

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

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

The Company is exposed to credit risk in connection with its receivables from customers. The carrying amount of the Company's accounts receivable represents the maximum credit exposure. The Company is also exposed to currency risk in connection with its foreign currency denominated receivables from customers, mainly in US dollars and to a lesser extent in Japanese yen, Australian dollars, and the Euro.

Sales transactions are made through the extension of credit to customers and are recorded at the point in time the sale is recognized. Accordingly, fluctuations in collectability may affect the carrying value of the underlying accounts receivable. Management balances the credit risk through rigorously and continually reviewing customer credit profiles. The Company has established policies and controls to review the creditworthiness of new customers, including review of credit ratings. Most lumber sales are conducted under standard industry terms and conditions and most export sales are insured by the Export Development Corporation. The Company regularly reviews the collectability of accounts receivable and makes provisions where the collectability is uncertain. Historically the Company's bad debts have been minimal and as at December 31, 2010, the Company had an allowance for doubtful customer accounts of \$0.5 million (2009 - \$0.4 million).

As previously disclosed, certain sales transactions are denominated in foreign currencies, principally, the US dollar. Accordingly, fluctuations in foreign exchange rates may affect the carrying value of the underlying accounts receivable. As of December 31, 2010, the Company's accounts receivable denominated in US dollars totaled \$24.8 million. An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in a decrease (increase) in US dollar denominated accounts receivable at year end of approximately \$0.2 million. In addition, as at December 31, 2010, the Company had a total of \$6.8 million in US dollar denominated cash and cash equivalents. An increase (decrease) in the value of the Canadian dollar by US\$0.01 would result in immaterial change to US dollar denominated cash and cash equivalents at year end.

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17. Financial instruments (continued):

The Company is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. The Company's cash and cash equivalents include bank accounts and highly liquid money market instruments with maturities of 90 days or less from the date of acquisition. Management mitigates the interest rate risk associated with the long term debt through the utilization of floating interest rates. Based on the Company's debt structure at December 31, 2010, a change of 1% in interest rates would have increased or decreased annual net income by approximately \$1.0 million. The Company does not currently use derivative instruments to reduce its exposure to interest rate risk.

From time to time the Company may recognize liabilities for the settlement of certain obligations. The amount recognized in the financial statements is based on management's best estimate given the facts available at the time the obligation was incurred. Accordingly, fluctuations in pricing and interest rates will affect the ultimate cost to settle a given obligation. Management mitigates the associated pricing risk through regularly reviewing the assumptions used in the generation of the estimate.

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

Liabilities for ongoing operations are recorded in the financial statements at cost accrued to that point in time. Management mitigates any liquidity risk associated with the subsequent payment of these liabilities through the continual monitoring of expenditures and forecasting of liquidity resources. The Company maintains a revolving credit facility that can be drawn down to meet short-term financing and liquidity needs. As at December 31, 2010, the Company's total available and unused liquidity was \$84.6 million (2009 - \$37.3 million). The Company's estimated cash payments with respect to contractual and legal obligations for each of the next five years and thereafter are as follows:

<i>(millions of dollars)</i>	Total	2011	2012	2013	2014	2015	Thereafter
Accounts payable and - accrued liabilities	\$ 61.6	61.6	-	-	-	-	-
Discontinued operations	6.2	6.2	-	-	-	-	-
Revolving term loan	75.0	-	-	75.0	-	-	-
Non-revolving term loan	31.2	-	31.2	-	-	-	-
Operating leases	16.7	3.4	2.3	1.5	1.3	1.3	6.9
Reforestation liability	26.1	11.4	4.6	2.7	1.7	1.2	4.5
Other long-term liabilities	2.2	-	-	-	-	-	2.2
Defined benefit pensions - funding obligations	12.4	2.9	2.9	2.2	2.2	2.2	-
Total	\$ 231.4	85.5	41.0	81.4	5.2	4.7	13.6

18. Operating restructuring items:

Operating restructuring items for 2010 of \$1.6 million (2009 - \$5.5 million) primarily relate to severance costs associated with a number of the Company's operating divisions. In 2010 this relates primarily to severance obligations incurred as a result of restructuring the Company's Japanese sales organization, the closures of our Mid-Island Remanufacturing operation and Andy's Bay logging facility, and the re-organization of our Ladysmith sawmill. In 2009 the severance costs were primarily associated with the restructuring of the Company's timberlands operations.

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19. Net interest expense:

	<u>2010</u>	<u>2009</u>
Revolving credit facility	\$ 0.9	\$ 2.0
Long-term debt	8.7	7.1
Amortization of deferred financing costs	2.8	1.7
	<u>\$ 12.4</u>	<u>\$ 10.8</u>

20. Other income:

Other income of \$24.3 million in 2010 comprises: gains on the disposal of non-core assets of \$8.6 million; a gain of \$8.9 million (net of costs of \$0.5 million) related to the establishment of a jointly-owned entity in October 2009, with Brookfield Properties Limited ("Brookfield"), a company related to BAM (Note 22); a further receipt of \$5.2 million from the Province of British Columbia relating to reimbursement of costs incurred by Western with respect to Bill 28 timber take-back areas (Note 14 (g)); and sundry other miscellaneous items aggregating to \$1.6 million. The most significant non-core asset sale reported in 2010 was the sale of land located in the southern part of Vancouver Island for proceeds of \$14.3 million to the Capital Regional District of Victoria, British Columbia, which closed in August 2010. As part of this transaction the Company also agreed to sell a further two parcels of land for proceeds of \$4.5 million which, as a condition of sale, require the Company to secure a Certificate of Compliance on an environmental remediation project under way. The Company has until August 15, 2012 to secure that certificate, and until the certification is obtained this element of the sale will not be recorded. At December 31, 2010 \$9.7 million of the proceeds had been received with a further \$3.3 million due on August 12, 2011 and \$5.8 million on August 15, 2012, assuming that the aforementioned certification is obtained. The transaction generated an accounting gain of \$7.1 million. \$16.1 million of the proceeds received from the sales of non-core assets in 2010 was used to pay down long-term debt (2009 - \$6.4 million).

Other income of \$7.4 million received in 2009 related to gains on non-core asset sales and also to compensation payments received from the Province of British Columbia for the reimbursement of costs incurred by Western with respect to Bill 28 related timber take-back areas and for infrastructure costs incurred in certain expropriated timber tenures following the creation of new Conservancies in the Central Coast region.

21. Discontinued operations:

In March 2006, the Company closed its Squamish 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.

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21. Discontinued operations (continued):

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

	<u>2010</u>	<u>2009</u>
Net loss from discontinued operations	<u>\$ (1.5)</u>	<u>\$ (2.0)</u>
Cash used by discontinued operations	<u>\$ (1.5)</u>	<u>\$ (3.1)</u>
Assets of discontinued operations	<u>\$ 2.3</u>	<u>\$ 2.2</u>
Liabilities of discontinued operations	<u>\$ 6.2</u>	<u>\$ 6.1</u>

22. Related party transactions:

In addition to the related party transactions identified elsewhere in these consolidated financial statements, the Company has certain arrangements with entities related to 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 during the year ended December 31, 2010:

	<u>2010</u>	<u>2009</u>
Costs incurred for:		
Log purchases	\$ 8.1	\$ 10.2
Other	4.8	3.7
	<u>\$ 12.9</u>	<u>\$ 13.9</u>
Income received for:		
Log sales	\$ 3.3	\$ 0.4
Other	9.4	0.3
	<u>\$ 12.7</u>	<u>\$ 0.7</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 (Note 23). 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.

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22. Related party transactions (continued):

Because BPL is a related party of BSSML, which is Western's largest shareholder, the transaction constituted a related party transaction.

23. Subsequent events:

On January 4, 2011, the Company exercised the option to sell its equity interest in WFPFPL, the entity that holds a joint venture established in 2009 between the Company and BPL (Note 22). Western received \$2.4 million as consideration for the sale of its interest, and the right of first offer was extinguished.

On February 11, 2011, the Company completed the sale of certain non-core properties to TimberWest Forest Corp. at the purchase price of \$21.9 million. The sale includes 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 will be used to pay down the Company's debt in accordance with its lending agreements.



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