Western Forest Products Inc.

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Western Forest Products Inc.

2018 Annual Report

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") reports and comments on the financial condition and results of operations of Western Forest Products Inc. (the "Company", "Western", "us", "we", or "our"), on a consolidated basis, for the three months and year ended December 31, 2018 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 our audited annual consolidated financial statements and the notes thereto for the years ended December 31, 2018 and 2017, which can be found on SEDAR at www.sedar.com.

The Company has prepared the consolidated financial statements for the years ended December 31, 2018 and 2017 in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board. Amounts discussed herein are based on our audited annual consolidated financial statements and are presented in millions of Canadian dollars unless otherwise noted. Certain prior period comparative figures have been reclassified to conform to the current period's presentation.

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

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

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

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

Unless otherwise noted, the information in this discussion and analysis is updated to February 12, 2019.

[1] Earnings Before Interest, Tax, Depreciation and Amortization

Summary of Selected Annual Information [1]

(millions of dollars except per share amounts and where otherwise noted)	As at and for the years ended December 31,		
	2018	**2017**	**2016**
Revenue			
Lumber	$ 952.9	$ 858.2	$ 883.5
Logs	160.0	214.8	235.6
By-products	83.8	70.4	68.2
Total revenue	$ 1,196.7	$ 1,143.4	$ 1,187.3
Operating income prior to restructuring items and other income (expense)	103.4	117.0	110.2
Net income	69.2	74.4	94.2
Adjusted EBITDA	$ 143.5	$ 152.6	$ 148.2
Adjusted EBITDA margin	12.0%	13.3%	12.5%
Basic and diluted earnings per share (in dollars)	$ 0.18	$ 0.19	$ 0.24
Cash dividends declared per share (in dollars)	0.0875	0.08	0.08
Total Assets	$ 855.8	$ 799.6	$ 777.2
Net Debt (Cash) [2]	(2.4)	(35.3)	15.4

(1) Included in Appendix A is a table of selected results for the last eight quarters.
(2) Net debt is defined as the sum of long-term debt, revolving credit facility, less cash and cash equivalents.

Overview

We delivered record revenue and strong adjusted EBITDA in 2018, despite the negative impacts of softwood lumber duties, significant increases in provincial stumpage rates and the effects of the worst coastal fire season on record. Our earnings were positively impacted by the benefits of our refined marketing strategy that supported higher price realizations despite commodity lumber price volatility. We accelerated strategic capital investments in our operations to increase the production of high-value, finished lumber and to improve our cost competitiveness.

Adjusted EBITDA of $143.5 million in 2018 included export tax expense of $43.0 million and stumpage expense of $52.7 million. Export tax expense increased by $27.2 million due to the application of softwood lumber duties for the full year of 2018. Higher coastal stumpage resulted in an incremental stumpage expense of $30.6 million.

We achieved record revenue of $1,196.7 million in 2018, an increase of 5% from 2017, despite a weaker specialty product sales mix and the temporary suspension of export log sales. We took advantage of robust commodity markets in the first half of 2018 by directing export logs to our mills to increase commodity lumber production.

Log production increased by 8% as we overcame the worst coastal fire season on record. Coastal fire conditions led to the full curtailment of our timberlands operations for August and early September, during which we directed resources to aid in firefighting efforts. Excluding stumpage expense, our timberlands costs were relatively flat year over year as the benefit of margin improvement initiatives offset increased contractor costs.

We increased lumber production by 9% as we leveraged a stronger opening log inventory to increase sawmill operating hours over 2017. Excluded from our 2018 production results was 14 million board feet of third-party custom cut production at our Ladysmith mill, to avoid temporary curtailment. Log supply at Ladysmith continues to be challenged by high coastal log exports and competition from pulp producers.

Our net income in 2018 was $69.2 million, as compared to $74.4 million in 2017. The benefits of margin improvement initiatives and leveraging our mill capital investments were offset by significant incremental export duty and stumpage expenses in 2018.

Strong operating cash flows were used to fund $95.1 million of capital expenditures, including $24.6 million invested in the acquisition and upgrade to our Arlington, Washington distribution and processing center. We returned $34.3 million to shareholders through regular, quarterly dividends and we repurchased $25.2 million of our outstanding common shares for cancellation. Liquidity was $250.4 million at December 31, 2018.

We continue to reposition our coastal assets and pursue external opportunities to grow our margin-focused business. We achieved another milestone in our collaborative work with coastal First Nations in December 2018, when we reached an agreement to sell a 7% ownership interest in our Port Alberni Forest Operation to the Huu-ay-aht First Nations for $7.2 million. The sale and partnership agreements are subject to customary closing conditions and are scheduled to be completed late in the first quarter of 2019.

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

Change to Board of Directors

Ms. Suzanne Blanchet tendered her resignation from the Board of Directors effective November 9, 2018, for personal reasons. The Company intends to fill the director vacancy through its ongoing candidate search.

Today, the Company announced the planned transition of its Board of Directors and certain Board Committees including the immediate appointment of director Michael Waites to Chair of the Board.

Summary of Selected Quarterly and Annual Results [1]

(millions of dollars except per share amounts and where otherwise noted)		Q4 2018	Q4 2017	Q3 2018	YTD 2018	YTD 2017
Summary Information						
Revenue						
Lumber		$ 230.9	$ 207.3	$ 238.2	$ 952.9	$ 858.2
Logs		36.2	56.6	33.6	160.0	$ 214.8
By-products		17.7	19.2	20.7	83.8	70.4
Total revenue		$ 284.8	$ 283.1	$ 292.5	$ 1,196.7	$ 1,143.4
Export tax		$ 10.1	$ 0.1	$ 11.5	$ 43.0	$ 15.8
Stumpage		13.8	7.9	10.9	52.7	22.1
Adjusted EBITDA		$ 18.0	$ 38.9	$ 32.3	$ 143.5	$ 152.6
Adjusted EBITDA margin		6.3%	13.7%	11.0%	12.0%	13.3%
Operating income prior to restructuring items and other income (expense)		$ 7.7	$ 30.3	$ 23.4	$ 103.4	$ 117.0
Net income for the period		5.3	19.0	15.1	69.2	74.4
Basic and diluted earnings per share (in dollars)		$ 0.02	$ 0.05	$ 0.04	$ 0.18	$ 0.19
Operating Information						
Lumber						
Lumber Shipments – millions of board feet[2]						
Western Red Cedar		47	53	51	205	232
Japan Specialty		37	37	31	138	150
Niche		24	19	24	96	84
Commodity		110	91	106	441	374
Total		218	200	212	880	840
Lumber Production – millions of board feet		200	184	221	864	792
Lumber Price – per thousand board feet		$ 1,059	$ 1,037	$ 1,124	$ 1,083	$ 1,022
Logs						
Log Shipments – thousands of cubic metres						
Export		1	84	10	65	459
Domestic		222	262	189	1,037	839
Pulp		146	147	109	407	365
Total		369	493	308	1,509	1,663
Net production – thousands of cubic metres[3]		1,135	1,099	815	4,328	4,008
Saw log purchases – thousands of cubic metres		212	343	197	979	1,150
Log Price – per cubic metre[4]		$ 98	$ 115	$ 109	$ 106	$ 120
Illustrative Lumber Average Price Data[5]	**Price Basis**					
Grn WRC #2 Clear & Btr 4x6W RL ($C)	c.i.f. dest. N Euro	$ 5,133	$ 4,950	$ 5,150	$ 5,100	$ 4,641
Grn WRC Deck Knotty 2x6 RL S4S	Net f.o.b. Mill	$ 1,418	$ 1,528	$ 1,503	$ 1,493	$ 1,484
Grn WRC #2 & Btr AG 6x6 RL	Net f.o.b. Mill	$ 2,245	$ 1,878	$ 2,215	$ 2,134	$ 1,780
Coast Grn WRC Std&Btr NH 3/4x4 RL S1S2E	Net f.o.b. Mill	$ 1,146	$ 1,184	$ 1,180	$ 1,171	$ 1,138
Grn Hem Baby Squares Merch 4-1/8x4-1/8 13' S4S	c.&f. dest. Japan	$ 1,000	$ 800	$ 1,000	$ 949	$ 766
Grn Dfir Baby Squares Merch 4-1/8x4-1/8 RL S4S	c.&f. dest. Japan	$ 1,200	$ 1,055	$ 1,235	$ 1,189	$ 1,026
KD White Fir Shop Moulding&Btr C&Btr 5/4 S2S	Net f.o.b. Mill	$ 1,080	$ 1,060	$ 1,080	$ 1,075	$ 1,060
Grn Dfir (Portland) #1&Btr 100% FOHC 6x6 Rough	Net f.o.b. Mill	$ 1,358	$ 1,165	$ 1,398	$ 1,369	$ 1,024
Hemlock Lumber 2x4 (40x90) Metric RG Utility	c.i.f. dest. Shanghai	$ 440	$ 466	$ 527	$ 486	$ 444
Average Exchange Rate – CAD to USD		0.756	0.787	0.765	0.771	0.770
Average Exchange Rate – CAD to JPY		85.32	88.84	85.32	85.19	86.39

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

(2) Comparative figures have been reclassified to conform to the current period's presentation, which reflects the reclassification of certain Niche products (Hemlock timbers and US-destined Yellow Cedar) from Commodity and Japan Specialty shipment totals.

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

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

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

Summary of Fourth Quarter 2018 Results

Adjusted EBITDA for the fourth quarter of 2018 was $18.0 million, as compared to $38.9 million from the same period last year. An incremental $10.0 million of export tax expense, an added $5.9 million of stumpage expense and a commodity-heavy sales mix more than offset improvements in specialty product price realizations. In addition, lower commodity lumber pricing drove a negative lumber and log inventory revaluation of $1.9 million, as compared to a positive adjustment of $2.5 million in the same period last year.

Operating income prior to restructuring items and other income decreased to $7.7 million from $30.3 million in the same period last year. Last year, we proactively increased Western Red Cedar ("WRC") pricing and shipments in advance of the application of lumber duties, and US countervailing lumber duty application was limited to three days in the quarter. In contrast, the fourth quarter of 2018 saw a return to a more normal seasonal WRC sales cycle and the full application of lumber duties.

Canadian to United States dollar ("USD") exchange rate volatility leading into year-end resulted in an unrealized mark-to-market expense of $2.2 million from outstanding foreign currency forward contracts, as compared to a $0.7 million unrealized gain in the fourth quarter of 2017.

Sales

Lumber revenue was $230.9 million, an increase of 11% from same period last year. We grew shipments by 9% and increased realized lumber pricing, despite a weaker sales mix and a steep decline in commodity lumber prices. Specialty lumber sales pricing was supported by a 26% increase in high-value WRC timbers. To mitigate declining commodity lumber prices, we significantly increased direct lumber sales into China.

As noted above, we returned to a more normal seasonal WRC sales cycle, which contributed to an 11% decrease in WRC shipments. Specialty lumber represented 49% of total fourth quarter shipments, as compared to 55% in the same period last year.

Fourth quarter log revenue was $36.2 million, a 36% decrease from the same period last year. Improved log pricing was more than offset by a weaker log sales mix. Log shipments decreased by 25% as compared to the fourth quarter of 2017, as we temporarily suspended our export log sales program to direct additional logs to our mills. The only export log shipment in the period originated from a short-term First Nation timber purchase agreement managed by Western.

By-products revenue was $17.7 million in the fourth quarter of 2018, as compared to $19.2 million in the same period in 2017. Pricing remained comparatively flat, on lower shipments due to reduced chip volumes purchased for resale.

Operations

Lumber production was 200 million board feet, a 9% increase over the fourth quarter of 2017, despite storm-related power outages and capital projects which interrupted production in late December. We grew lumber production by leveraging the benefit of our mill capital investments, well-positioned opening log inventory, and the redirection of export logs. We significantly increased year-over-year production at our Duke Point facility through improved operating efficiencies and higher operating hours. In addition, we grew finished lumber production from the upgraded planer. Recent investments in our Chemainus timber deck drove a 14% increase in high-value WRC timber production over the same period last year.

Fourth quarter manufacturing costs were 3% higher than the same period last year due to increased secondary processing and storm and capital related downtime. Our natural gas pricing was higher due to a temporary supply disruption.

Log production was 1,135,000 cubic metres, an increase of 3% from the fourth quarter of last year. We took advantage of improved harvest conditions to make up ground from fire-related curtailments in the third quarter, increasing closing log inventory by 6% compared to the end of 2017.

Excluding stumpage expense, our harvest costs were consistent with the fourth quarter of 2017. Stumpage expense increased by 75% as a result of provincial rate equation updates, the ongoing influence of coastal log exports and higher market log pricing, despite weaker lumber markets.

Saw log purchases were 212,000 cubic metres, a 38% decrease from the same quarter last year. Increased demand from export markets and pulp manufacturers reduced log supply to domestic sawmills and drove log prices higher.

Freight expense increased $1.4 million as compared to the fourth quarter of 2017. Higher freight expense was attributable to increased in-market sales to China, consistent with our strategy. Increased freight costs arising from a 9% increase in lumber shipments were largely offset by savings from lower log shipments.

Fourth quarter adjusted EBITDA and operating income included $10.1 million of countervailing duty ("CVD") and anti-dumping duty ("AD"), as compared to $0.1 million in the same quarter last year. CVD was not in effect until December 28, 2017. Duty expense in the fourth quarter of 2017 was offset by a $3.5 million export tax recovery due to differences in preliminary and revised duty rates.

Selling and Administration Expense

Fourth quarter selling and administration expense was $7.6 million in 2018, as compared to $7.4 million in the same period last year. A decline in our common share price over the quarter resulted in a $0.7 million mark-to-market recovery related to share-based compensation plans. We incurred comparatively greater expense related to foundational system and process improvements in support of our growth strategy.

Net Income

Net income for the fourth quarter of 2018 was $5.3 million, as compared to $19.0 million for the same period of 2017. Operating margins and net income were reduced by higher export duty and stumpage expenses.

Arlington Operations Update

In the fourth quarter of 2018, we invested $4.5 million in Arlington infrastructure and equipment upgrades. Approximately 24% of all US-bound shipments were distributed through the facility in the fourth quarter of 2018. With infrastructure upgrades and equipment installation nearing completion, we expect to commission secondary processing late in the first quarter of 2019, and continue to increase the portion of US-bound shipments distributed through Arlington.

Sale of Ownership Interest in Port Alberni Forest Operations

On December 14, 2018, Western announced it had reached an agreement whereby the Huu-ay-aht First Nations will acquire a 7% interest from Western in a newly formed Limited Partnership for $7.2 million, subject to closing adjustments (the "Transaction"). The assets of the Limited Partnership will consist of Port Alberni Forest Operation, including TFL 44 and certain other associated assets and liabilities. The Company will continue to source fibre from the Limited Partnership assets to support its BC manufacturing facilities.

The completion of the Transaction is subject to customary closing conditions and is scheduled to close late in the first quarter of 2019. As part of the agreement, Western may sell Huu-ay-aht First Nations an incremental interest in the Limited Partnership subject to further negotiation.

Columbia Vista Asset Acquisition

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

Summary of 2018 Annual Results

We delivered an annual adjusted EBITDA of $143.5 million in 2018 and adjusted EBITDA margin of 12.0%, despite facing the significant headwinds of an incremental $27.2 million in export duty expense and additional stumpage expense of $30.6 million; both of which more than doubled from last year. Operating income prior to restructuring items and other income decreased by 12% from 2017 to $103.4 million.

Sales

Lumber revenue increased by 11% in 2018 to $952.9 million, as we grew sales volumes and improved price realizations. Average lumber price realizations were 6% higher compared to 2017, despite proportionately higher commodity sales. Commodity lumber increased to 50% of total lumber shipments in 2018, from 45% in 2017. Conversely, WRC lumber shipments declined to 23%, from 28% in the prior year, due in part to a more normal seasonal WRC sales cycle in the fourth quarter of 2018. We grew shipments to China to capitalize on strong market demand and pricing, while at the same time partially mitigating the impact of US duties.

Log revenue was $160.0 million in 2018, a decrease of $54.8 million from 2017 due to a 9% decrease in log shipments. Lower log revenue was the result of the temporary suspension of our export log sales program in 2018, to supply our coastal sawmills and capitalize on increased demand for commodity lumber.

By-product revenue increased to $83.8 million in 2018, from $70.4 million in 2017. Chip price realizations increased 23%, more than offsetting a 7% reduction in sales volumes. Lower shipments were driven by reduced chip volumes purchased for resale.

Operations

Lumber production was 864 million board feet, a 9% increase over 2017. In addition, we produced 14 million board feet equivalent of custom cut production for a third party in the first quarter of 2018, which was not reflected in our lumber production volume. Higher opening log inventory and increased mill operating hours improved total production. In addition, we directed export logs into our manufacturing operations to leverage our flexible operating platform and capitalize on strong commodity markets in the first half of 2018. Operating costs were driven lower year-over-year through a heavier mix of commodity lumber and incremental benefits realized from our strategic capital initiatives.

The recapitalization of our Duke Point sawmill and improved opening log inventory facilitated a 30% increase in total operating hours as compared to 2017. The ramp-up of our rebuilt Duke Point planer operation has supported the reduction of secondary remanufactured lumber processed via higher-cost, third-party facilities, while growing our production of finished lumber products.

The cost benefits of these operating improvements were partly offset by a 25% increase in primary production volumes at third party custom cut facilities year-over-year. We leveraged these facilities in order to supply our customers' needs, optimize sawmill cut schedules and grow overall production.

Log production for 2018 was 4,328,000 cubic metres, 8% higher than 2017 despite the impact of the worst coastal fire season on record. Log costs were 7% higher, due to increased stumpage, a higher percentage of grapple yarding and the mix of operations offset by our margin improvement initiatives and reduced helicopter logging.

We supplemented our internal log supply with saw log purchases of 979,000 cubic metres, a 15% decrease from 2017. The temporary suspension of our export log program limited our ability to successfully procure logs from government-auctioned standing timber sales. Increased pricing for purchased logs was driven by strong demand.

Freight expense decreased by $12.6 million in 2018 to $90.6 million. The temporary suspension of our export log sales program more than offset the impact of a 5% increase in lumber shipments over 2017.

Selling and Administration Expense

Selling and administration expenses were $32.0 million, as compared to $32.8 million in 2017. Mark-to-market recovery related to share-based compensation plans more than offset increased IT costs related to foundational system and process improvements in support of our growth strategy.

Finance Costs

Finance costs were $2.7 million in 2018 compared to $2.5 million in 2017.

On August 8, 2018, we announced the execution of a new $250 million syndicated credit facility. The facility, which matures on August 1, 2022, includes an accordion feature to access an additional $100 million of debt. As part of this refinancing, we recognized the remaining deferred financing costs of the previous credit facilities. The Company had drawings of $7.0 million on the credit facility as at December 31, 2018.

Net Income

Net income was $69.2 million, as compared to $74.4 million in 2017. Reduced operating margins were offset by reduced operating restructuring items and lower income tax expense.

Operating Restructuring Items

We incurred $4.8 million of operating restructuring costs in 2018, including $2.2 million relating to the indefinite curtailment of our Somass sawmill; $1.5 million in severance and related expenses attributable to ongoing business optimization initiatives; and $0.6 million incurred to retrain employees affected by the closure of the Englewood train operation. Operating restructuring costs were $14.4 million in 2017, due primarily to the indefinite curtailment of our Somass sawmill and closure of the Englewood train.

Our Somass sawmill remains indefinitely curtailed as a result of a fibre supply deficit arising from years of tenure takebacks and government land use decisions, and rising costs associated with the US Softwood Lumber dispute. We are evaluating options to create a sustainable, long-term solution for the site, and we are considering the input of government, First Nations and other stakeholders.

Income Taxes

We used the majority of our remaining non-capital loss carryforwards during the second quarter of 2018, which will result in cash taxes payable for the tax year ending December 31, 2018. Accordingly, current income tax expense of $14.3 million and deferred income tax expense of $11.3 million, respectively, were recognized in net income in 2018. Total income tax expense decreased by $1.3 million from 2017 as a result of lower operating earnings.

Deferred income tax recovery of $0.2 million was recognized through other comprehensive income as a result of actuarial losses arising from our legacy defined benefit pension plans. In 2017, we recognized deferred income tax recovery of $0.7 million through other comprehensive income as a result of actuarial losses arising from these pension plans.

At December 31, 2018, the Company and its subsidiaries had unused non-capital loss carry forwards totaling approximately $2.0 million in Canada, and $2.1 million in the US, which can be used to reduce taxable income. In addition, the Company has unused capital losses carried forward of approximately $93.7 million in Canada, which are available indefinitely.

In May 2018, the Company received correspondence from the Canada Revenue Agency (“CRA”) regarding certain restructuring transactions, occurring in 2004 and 2007 to 2011, and the general anti-avoidance rule. Management believes the CRA’s position is without merit. Management is prepared to defend its position if a notice of reassessment is issued, and as such, the Company has not recognized any income tax provision as at December 31, 2018 relating to this matter.

Financial Position and Liquidity

(millions of dollars except where otherwise noted)	Q4 2018	Q4 2017	Q3 2018	YTD 2018	YTD 2017
Selected Cash Flow Items					
Operating Activities					
Net income	$ 5.3	$ 19.0	$ 15.1	$ 69.2	$ 74.4
Amortization	9.9	9.4	9.6	40.2	36.3
Other	2.9	3.5	1.2	23.6	18.1
Subtotal	18.1	31.9	25.9	133.0	128.8
Change in non-cash working capital	(12.5)	(28.4)	14.2	(14.8)	5.6
Cash provided by (used in) operating activities	$ 5.6	$ 3.5	$ 40.1	$ 118.2	$ 134.4
Investing Activities					
Additions to property, plant and equipment	$ (27.4)	$ (19.3)	$ (17.7)	$ (70.6)	$ (41.7)
Additions to capital logging roads	(3.6)	(3.2)	(3.0)	(12.9)	(13.5)
Purchase of Arlington facility	-	-	-	(11.6)	-
Other	2.0	0.1	0.8	3.1	7.1
Cash provided by (used in) investing activities	$ (29.0)	$ (22.4)	$ (19.9)	$ (92.0)	$ (48.1)
Financing Activities					
Repayment of debt	$ -	$ -	$ -	$ -	$ (35.0)
Dividends	(8.7)	(8.0)	(8.8)	(34.3)	(31.7)
Share repurchases	(9.1)	(2.7)	(10.4)	(25.2)	(2.7)
Other	6.8	(0.3)	(0.3)	6.4	(0.6)
Cash provided by (used in) financing activities	$ (11.0)	$ (11.0)	$ (19.5)	$ (53.1)	$ (70.0)
Increase (decrease) in cash	$ (34.4)	$ (29.9)	$ 0.7	$ (26.9)	$ 16.3
Summary of Financial Position					
Cash and cash equivalents	$ 8.4	$ 35.3	$ 42.8		
Current assets	297.9	292.5	324.6		
Current liabilities	142.7	107.8	146.0		
Total debt, net of deferred financing costs	6.0	-	-		
Net debt (cash) (1)	(2.4)	(35.3)	(42.8)		
Shareholders' equity	572.9	562.7	586.6		
Total liquidity (2)	250.4	269.3	291.8		
Financial ratios:					
Current assets to current liabilities	2.09	2.71	2.22		
Net debt to capitalization (3)	-	-	-		

(1) Net debt (cash) is defined as the sum of long-term debt, less cash and cash equivalents.
(2) Total liquidity comprises cash and cash equivalents, and available credit under the Company's credit facility.
(3) Capitalization comprises net debt and shareholders' equity.

Cash provided by operating activities in 2018 was $118.2 million as compared to $134.4 million in 2017. We invested $95.1 million in capital including $24.6 million for the acquisition and upgrades to our Arlington, Washington distribution and processing facility. We increased our dividend by 12.5%, returning $34.3 million to shareholders through quarterly dividends, and repurchased $25.2 million of our common shares for cancellation under our normal course issuer bid.

Cash used in investing activities was $92.0 million in 2018, as compared to $48.1 million invested in 2017. We increased capital investments in 2018, including $36.0 million in strategic capital investments ranging from the Arlington acquisition to numerous high-return, low cost capital projects. Our strategic capital program is discussed in more detail under "*Strategy and Outlook*".

Cash used in financing activities decreased to $53.1 million in 2018, as compared to $70.0 million in 2017, which included repayment of the remaining $35.0 million of debt outstanding.

Total liquidity decreased to $250.4 million at December 31, 2018, from $269.3 million at the end of 2017. Liquidity is comprised of cash and cash equivalents of $8.4 million and unused availability under the credit facility of $242.0 million. Based on our current forecasts, we expect sufficient liquidity will be available to meet our obligations in 2019.

Capital Allocation

Normal Course Issuer Bid

On August 3, 2018, the Company renewed its Normal Course Issuer Bid ("NCIB") permitting the purchase and cancellation up to 19,662,439 of the common shares or approximately 5% of the common shares issued and outstanding as of August 3, 2018.

In 2018, the Company repurchased 11,695,573 common shares under the NCIB for $25.2 million at an average price of $2.15 per common share.

As at February 12, 2019, 8,498,617 common shares remain available to be purchased under the current NCIB. The NCIB expires on August 7, 2019.

Strategy and Outlook

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

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

Strengthen the Foundation

- We have developed a track record of consistently delivering positive operating income and a balanced approach to capital allocation.
- Through our focused capital investments we have positioned Western as the only company on the coast of BC capable of consuming the complete profile of the coastal forest and competitively manufacturing a diverse product mix.
- The strategic capital investments completed and activated within the last two years have allowed us to increase the production of targeted products and supported the consolidation of our coastal operations. By advancing the recapitalization and consolidation of our coastal operating base, we have improved the financial performance and stability of our business.
- We continue to invest in people and systems to create a platform for growth in our existing operations and to accelerate our pursuit of margin-focused growth opportunities.
- We continue to pursue opportunities for long-term, mutually beneficial relationships with coastal First Nations. We recently announced the sale of an ownership interest in our Port Alberni Forest Operation to Huu-ay-aht First Nations, aligning our interests and introducing an opportunity to potentially involve other First Nations in a shared vision for forestry.

Grow the Base

- We have grown annual revenue to $1.2 billion, more than double the revenue reported in 2009.
- We continue to optimize our operations and invest in our mills and timberlands to improve margins and position ourselves for growth.
- We have implemented a non-capital margin improvement program to improve our cost structure and optimize our supply chain.
- The success of our business relationships with First Nations continues to drive incremental log volume and has enabled Western to grow specialty lumber production in recent years.
- We are delivering on a strategy that drives the production and sale of targeted, high-margin products of scale to selected customers that value our product offerings.

Explore Opportunities

- Our ongoing reinvestment in and consolidation of our coastal operating base and steady operating improvements have delivered improved financial performance and a strong balance sheet that will support continued growth of our margin-focused business.
- In 2018 we acquired a distribution and processing centre in Arlington, Washington, integrated the distribution operations and are poised to start secondary processing in the first quarter of 2019.
- In early 2019 we completed an acquisition of the assets of Columbia Vista Corporation in Vancouver, Washington, that will enable us to offer a broader array of Douglas fir specialty products to our selected customers in both the US and Japan.
- To meet our selected customers' needs we have launched a new wholesale business which will provide complementary products to our industry leading specialty product offerings and enhance our return on capital employed.
- We continue to evaluate opportunities to grow shareholder value.

Sales & Marketing Strategy Update

We are progressing with the execution of our sales and marketing strategy that focuses on the production and sale of targeted, high-margin products of scale to selected customers. We supplement our key product offerings with purchased lumber to deliver the suite of products our customers require. To accelerate and lead our sales and marketing initiatives, we made the following executive management additions in the fourth quarter of 2018:

Bruce Alexander joined Western as the Senior Vice President, Sales, Marketing and Manufacturing. Mr. Alexander is an experienced executive and brings over 30 years of sales, manufacturing and management experience in the forest products and manufacturing industries, including on the coast of BC. Mr. Alexander will be responsible for positioning Western as the leading global supplier of specialty building materials. Common leadership of sales, marketing and manufacturing business units will drive alignment between these functions, and is expected to optimize the production of targeted products of scale and grow our selected customer base worldwide.

Don McGregor joined Western as Vice President, Wholesale Lumber. Mr. McGregor brings almost 30 years of lumber marketing experience, including more than 20 years as President of Vanport Canada, a leading wholesale lumber company. Mr. McGregor is responsible for leading wholesale lumber operations and, in building relationships with global suppliers, broadening the scope of our specialty product offerings. Through the existing industry-leading product portfolio and complementary supply from new supply relationships, Mr. McGregor will expand product offerings to deliver greater value to our selected customers.

Market Outlook

Despite the recent volatility in commodity lumber pricing, our long-term view of market fundamentals remains unchanged. In North America, rising lumber consumption will continue to be driven by increased new home construction and a robust repair and renovation sector. We expect lumber demand in China to continue to grow due to a government commitment to housing, while in Japan, lumber consumption is expected to remain relatively stable over the next few years.

The supply of commodity lumber exceeded demand in North America in the second half of 2018 as new home construction stalled. Benchmark KD SPF 2x4 pricing fell more than 49% from the peak in May 2018 which led to numerous mill production curtailments. Demand in China for commodity lumber has remained relatively strong despite declining prices. We successfully grew China lumber shipments by 12% in 2018. Lumber shipments to Japan declined by 19% in 2018 mainly due to limited Douglas fir log availability.

Looking ahead, we anticipate North American demand and pricing for commodity lumber to improve as we enter the spring building season. However, we do not expect pricing to repeat last year's record performance as idled commodity lumber capacity is likely to respond to improved demand, moderating any pricing response. Lumber pricing in China has reset and is expected to remain flat through the first quarter of 2019, as that market enters the seasonal holiday slowdown. We will continue to monitor these prices and make adjustments in our operating plans accordingly.

In the first half of 2019, we expect WRC pricing trends to be product specific. We anticipate prices to remain stable for WRC timbers and wide width WRC products. In contrast, we expect the narrow width WRC lumber market to remain weak due to substitution from low priced imported lumber and an abundant supply of narrow-width US cedar lumber production. We anticipate pricing in high-value WRC export markets to weaken. To mitigate the impact of lower WRC pricing we will endeavor to manage our product mix.

Our Japan product mix is expected to improve with the inclusion of Douglas fir sales from our Columbia Vista division. We expect demand in Japan to be relatively stable for the first half of 2019, as builders look to complete projects ahead of an expected increase in the Japanese consumption tax. The recent closure of a Japanese fir sawmill is expected to support fir pricing. Demand for hemlock products is expected to remain pressured due to domestic product substitution.

We expect further decreases in domestic saw log prices in response to declining lumber markets through the first quarter of 2019.

Strategic Capital Program Update

We continue to implement a strategic capital program that is designed to position Western as the only company capable of sustainably consuming the complete profile of the coastal forest and competitively manufacturing a diverse product mix for global markets.

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

In the fourth quarter of 2018, we continued to make advancements with the latest phase of the Duke Point planer rebuild and progressed on a number of small, high-return capital projects focused on debottlenecking our manufacturing operations.

We completed our acquisition of Columbia Vista Corporation in Vancouver, Washington on February 1, 2019 for US$30.5 million, subject to post closing working capital adjustments. The assets acquired include a sawmill operation and separate remanufacturing site with 18 dry kilns and planer facilities.

Scheduled for the first half of 2019 are the completion of a series of high-return, low-cost strategic capital projects at our Duke Point, Saltair and Cowichan Bay operations, along with the modernization of our forklift fleet as we implement a centralized fleet management program. We will continue to upgrade our processing equipment at Arlington and expect the facility to begin commissioning in the first quarter of 2019.

Softwood Lumber Dispute and US Market Update

Western's results for 2018 include $43.0 million of export duty expense, comprised of CVD and AD expense. At February 1, 2019, Western had $64.9 million of cash on deposit with the US Department of Treasury in respect of these softwood lumber duties.

The US application of duties continues a long-standing pattern of US protectionist action against Canadian lumber producers. We disagree with the US trade determination and the inclusion of specialty lumber products, particularly Western Red Cedar and Yellow Cedar products in this commodity lumber focused dispute. As duties paid are determined on the value of lumber exported, and as our shipments to the US market are predominantly high-value, appearance grade lumber, we are disproportionately impacted by these duties. We have filed a Chapter 19 North American Free Trade Agreement ("NAFTA") separate-like-product challenge, on which a ruling is not expected until late 2019.

US market sales represent less than 25% of Western's total revenue in 2018. Continued strong demand and a lack of supply has supported improvements in our specialty lumber product pricing, partly offsetting the impact of duties.

Our acquisition of a distribution and processing centre in Arlington, Washington and the assets of Columbia Vista Corporation in Vancouver, Washington are expected to partially mitigate the damaging effects of duties on our products destined for the US market while increasing US market sales. We intend to leverage our flexible operating platform to continue to overcome any challenges that arise from this trade dispute. Refer to "*Risks and Uncertainties - Softwood Lumber Dispute"* below for a more detailed softwood lumber dispute timeline.

Summary of Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2018 and our payments due for each of the next five years and thereafter, including estimated interest payments:

(millions of Canadian dollars)	Total	2019	2020	2021	2022	2023	Thereafter
Accounts payable and accrued liabilities	$ 132.7	$ 132.7	$ -	$ -	$ -	$ -	$ -
Long-term debt	11.5	1.2	1.2	1.2	7.9	-	-
Operating leases	21.8	4.0	3.5	3.1	2.5	2.1	6.6
Reforestation obligation	26.7	10.1	4.4	2.8	1.8	1.4	6.2
Defined benefit pension plan funding obligation	25.7	3.1	3.1	3.1	3.1	3.0	10.3
Columbia Vista acquisition	41.6	41.6	-	-	-	-	-
	$ 260.0	$ 192.7	$ 12.2	$ 10.2	$ 15.3	$ 6.5	$ 23.1

Non-GAAP Measures

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

(millions of dollars except where otherwise noted)	**Q4 2018**	**Q4 2017**	**Q3 2018**	**YTD 2018**	**YTD 2017**
Adjusted EBITDA					
Net income	$ 5.3	$ 19.0	$ 15.1	$ 69.2	$ 74.4
Add:					
Amortization	9.9	9.4	9.6	40.2	36.3
Changes in fair value of biological assets, net	0.4	(0.7)	(0.8)	(0.1)	(0.6)
Operating restructuring items	(0.4)	3.1	1.7	4.8	14.4
Other (income) expense [1]	0.9	(0.5)	-	1.1	(1.2)
Finance costs	0.7	0.5	0.9	2.7	2.5
Current income tax (recovery) expense	-	-	6.2	14.3	0.2
Deferred income tax expense	1.2	8.2	(0.5)	11.3	26.7
Adjusted EBITDA	$ 18.0	$ 38.9	$ 32.3	$ 143.5	$ 152.6
Adjusted EBITDA margin					
Total revenue	$ 284.8	$ 283.1	$ 292.5	$ 1,196.7	$ 1,143.4
Adjusted EBITDA	18.0	38.9	32.3	143.5	152.6
Adjusted EBITDA margin	6.3%	13.7%	11.0%	12.0%	13.3%
Net debt to capitalization					
Net debt					
Total debt, net of deferred financing costs	$ 6.0	$ -	$ -		
Cash and cash equivalents	(8.4)	(35.3)	(42.8)		
Net debt (cash)	$ (2.4)	$ (35.3)	$ (42.8)		
Capitalization					
Net debt (cash)	$ (2.4)	$ (35.3)	$ (42.8)		
Add: Shareholders' equity	572.9	562.7	586.6		
Capitalization	$ 570.5	$ 527.4	$ 543.8		
Net debt to capitalization	-	-	-		

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

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

Included in the net income to adjusted EBITDA reconciliation for 2017 was $8.7 million related to the indefinite curtailment of our Somass sawmill; $2.4 million related to the closure of the Englewood train; $3.4 million in property sales gains; and a $3.1 million reduction to cost of goods sold for WorkSafeBC Certification of Recognition insurance premium rebates received for the 2014 and 2016 fiscal years.

Critical Accounting Estimates

Reforestation Obligation

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

Valuation of Inventory

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

Valuation of Accounts Receivable

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

Pension and Other Post Retirement Benefits

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

Environmental Provisions

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

Contingencies

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

Valuation of Biological Assets

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

Impairments

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

Income Tax Assets and Liabilities

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

Deferred Income Taxes

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

Accounting Policies and Standards

Please refer to Note 2(g), 19 and 23 of our audited annual consolidated financial statements for the year ended December 31, 2018 for further information on the accounting standards referenced below.

New Accounting Standards

The Company has adopted the following standards with a date of initial application of January 1, 2018, which had no significant impact on the Company's interim financial statements:

- IFRS 15, *Revenue from Contracts with Customers*
- IFRS 9, *Financial Instruments*

Accounting Standards and Interpretations not yet Adopted

A number of new and amended IFRS standards are not yet effective for the year ended December 31, 2018 and have not been applied in preparing these interim financial statements. IFRS 16, *Leases* ("IFRS 16") is considered by the Company to be the most significant of several pronouncements that may affect future financial statements. The Company intends to adopt IFRS 16 in its consolidated financial statements for the year commencing January 1, 2019.

The Company plans to apply a modified retrospective approach upon adoption of IFRS 16. Under the modified retrospective approach, the Company will calculate the right of use assets and lease liabilities as at January 1, 2019 and will not restate comparative information. Rather, the Company will recognize the cumulative effect of initially applying the standard as an adjustment to equity at the date of application. The Company continues to evaluate the impact of adopting the new standard which will be completed and disclosed in the consolidated financial statements in the first quarter of 2019. The Company anticipates that upon transition, the impact to its consolidated financial statements will be an increase in non-current assets and liabilities of less than 3% of total assets. Following the adoption of this standard, the consolidated statement of comprehensive income will recognize depreciation in cost of goods sold and finance costs for operating lease payments previously expensed in cost of goods sold.

Financial Instruments and Other Instruments

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

During 2018, the Company entered into foreign exchange forward contracts to sell USD and JPY in order to partially mitigate its foreign currency risk. At December 31, 2018, the Company had forward contracts in place to sell an aggregate USD $62.3 million and JPY 155.0 million (2017: USD 43.0 million; JPY 325.0 million). A net loss of $5.1 million was recognized on contracts which matured in the year (2017: net gain of $0.7 million), which is included in sales in the consolidated statement of comprehensive income.

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

Off-Balance Sheet Arrangements

Other than operating leases for vehicles, equipment and machinery, the Company does not have any off-balance sheet arrangements as at December 31, 2018.

Related Party Transactions

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

	Years ended December 31, 2018	2017
Salaries, directors' fees and short-term benefits	$ 7.2	$ 6.6
Post-employment benefits	0.3	0.3
Share-based compensation, including mark-to-market adjustment	2.7	4.4
	$ 10.2	$ 11.3

Risks and Uncertainties

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

Environmental Regulation

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

- air emissions, and land and water discharges;
- operations or activities affecting watercourses or the natural environment;
- operations or activities affecting species at risk and critical habitats;
- 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.

Western is one of five founding members of the Coast Forest Conservation Initiative (the “CFCI”), a collaborative effort amongst forest companies working in BC's Central and North Coast. Its purpose is to define and support the development of an ecosystem-based management as part of 2003 Land and Resource Management Plan recommendations. The CFCI Companies, along with major environmental groups delivered a suite of recommendations for consideration by the Province and the First Nations who live in the region. On January 28, 2016 the Province enacted, by Order in Council, the GBR Order. On May 19, 2016, the Great Bear Rainforest (“GBR”) (Forest Management) Act received Royal Assent in the BC legislature and this Act was subsequently brought into force on December 20, 2016 with an Order in Council (number 974). As a result of the GBR related legislation the Company’s Allowable Annual Cut (“AAC”) in the GBR area was reduced from 522,774 m^3 per year to 427,005 m^3 per year, effective January 1, 2017. Further, Forest Licence A19244 was subdivided by the Province into two forest licences to ensure timber harvest attributed to the GBR area is wholly contained in licences that only include forest operations in the GBR area. WFP’s Tree Farm Licenses within the GBR were also partitioned. TFL 39 has a GBR specific AAC of 41,300 m^3 per year that can only be harvested from the TFL blocks within the GBR.

Safety

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

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 economic activity or other causes including weather;
- Customers experiencing reduced access to credit; and
- Inventory de-stocking by customers.

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

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, the strength of the housing markets in the US and Japan, the rate of development in China, 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 45% and 55% of our total product sales are denominated in USD and between 4% and 8% in JPY, while most operating costs and expenses are incurred in CAD, with small portions in USD and JPY. The Company's functional currency is the CAD and financial results are reported in CAD. Significant variations in relative currency values, particularly significant changes in the value of the CAD relative to the USD, 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 CAD compared to the USD and JPY would decrease or increase annual operating earnings by approximately $4.3 million, and $0.4 million, respectively.

Softwood Lumber Dispute

The softwood lumber agreement ("SLA") between Canada and the United States, under which the Company's exports to the US could be assessed an export tax by the Canadian Government, expired on October 12, 2015, eliminating export tax measures on Canadian softwood lumber shipments to the US.

The twelve-month standstill period of the SLA, which precluded the US from bringing trade action against Canadian softwood lumber producers, expired October 12, 2016. On November 25, 2016, the US Lumber Coalition petitioned the US Department of Commerce ("DoC") and the US International Trade Commission ("ITC") seeking CVD and AD on Canadian softwood lumber shipments to the US.

On January 6, 2017, the ITC concluded that there was "reasonable indication" that softwood lumber products from Canada materially injured US producers; and, as a result, the DoC continued its ongoing CVD and AD investigations on these products.

On April 24, 2017, the DoC announced a preliminary countervailing duty of 19.88% for "all other" Canadian lumber producers including Western, effective April 28, 2017, and on June 26, 2017, the DoC announced a preliminary "all other" anti-dumping duty rate of 6.87% effective June 30, 2017. The DoC also made preliminary determinations on critical circumstances in April that resulted in 90-day retroactive application of countervailing duty from January 28 to April 27, 2017, and anti-dumping duty from April 1 to June 29, 2017.

The preliminary countervailing duties were applicable through August 25, 2017, after which they were suspended pending final determinations by the DoC and the ITC. On November 2, 2017, the DoC announced final determinations in its countervailing duty and anti-dumping duty investigations, concluding that critical circumstances did not exist for countervailing duty, but did exist for anti-dumping duty.

On December 7, 2017, the ITC announced a final injury determination, voting that exports of softwood lumber from Canada injured US producers. Concurrently, the ITC lowered the final countervailing duty rate to 14.19% and lowered the final antidumping duty rate to 6.04%, for "all other" Canadian lumber producers including Western, and concluded that critical circumstances did not exist for AD. The final rates are effective December 28, 2017. Due to the difference in preliminary and final rates applied for CVD and AD deposits, Western recorded an export tax recovery of $3.5 million in the fourth quarter of 2017.

On January 3, 2018, US Department of Commerce published amended final determinations, resulting in reduced, final CVD and AD rates of 14.19% and 6.04% respectively for "all other" Canadian lumber producers including Western.

In May 2018, we filed a NAFTA challenge to contest the ITC's finding that goods manufactured from Cedar (including WRC, Yellow Cedar and Redwood species) were not a separate product group from lumber manufactured from other softwood species. Rebuttal briefs from the US Lumber Coalition and US International Trade Commission were received in October 2018 and we filed our response in late 2018, on which a ruling is not expected until late 2019.

Employees and Labour Relations

Hourly paid employees at our Canadian manufacturing facilities, timber harvesting operations and a small group of clerical employees are unionized. The majority of the unionized employees are represented by the United Steel Workers ("USW"), which holds two collective agreements with the Company. Approximately 1,500 Western employees represented by the USW are covered by a five-year collective agreement, expiring June 15, 2019. An agreement with the USW covering 4 office clerical employees is in effect until December 31, 2019. The Pulp, Paper & Woodworkers of Canada ("PPWC") represents the remaining unionized employees. The PPWC collective agreement for the Ladysmith Sawmill (82 employees), expires on December 31, 2019. The PPWC also represents the unionized employees at our Value-Added Remanufacturing Operation (86 employees) runs through until October 14, 2021.

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 lockout could occur. A strike or lockout could involve significant disruption of operations and/or an adverse material impact on our financial condition. Furthermore, a negotiated settlement could result in unplanned increases in wages or benefits payable to unionized employees. In addition, the Company relies on certain third parties, such as logging contractors, stevedores, trucking companies and railways, whose workforces are unionized, to provide the Company with services necessary to operate the business. If those workers/employers engage in a strike or lockout, our operations could be disrupted.

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

Forest Resource Risk, Natural Catastrophes and Climate Change

Our timber tenures are subject to the risks associated with all standing forests, in particular, forest fires, wind storms, insect infestations and disease. Procedures and controls are in place to try and mitigate such risk through prevention and early detection. Most of the timber that we harvest comes from Crown tenures and insurance coverage is maintained only for loss of logs following harvesting due to fire and other occurrences. 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. In 2016, Western entered into a cost-sharing agreement with the Crown for our private timberlands to share individual incident costs of mobilizing helicopters and aerial water tankers in the event of a fire on those lands.

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

Other than the sales offices in Japan and China, all of our business operations are located on the BC coast and the US Pacific Northwest, which are 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 may also 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, may shift over time. While we are unable to predict the impact of all of these potential factors on our tenures or on forest practices, we have incorporated considerations for climate change in our reforestation practices as facilitated through Provincial policy and legislation.

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

Impact of Mountain Pine Beetle and Spruce Beetle Infestation

The interior forests of BC and western parts of Alberta have been, and continue to be, seriously damaged by North America’s largest recorded mountain pine beetle infestation. Over the past few years there has also been a growing concern with spruce beetle that is now killing live trees. Western does not operate in the affected areas and lodgepole pine, the species most at risk from the infestation, is not a key source of timber in the coastal forests. While coastal forests do contain Sitka spruce, large scale spruce beetle infestations killing live trees has only been recorded in Engelmann and white spruce tree species throughout North America. Those tree species are concentrated in the interior of BC and are not a source of timber for Western. The pine beetle infestation has caused widespread mortality of lodgepole pine and spruce beetle infestations are growing in scale in the interior. There is growing evidence that, as the dead trees decay, they become more difficult and costly to manufacture into lumber and that the quality of the residual wood chips may diminish. There may also be access issues over time as developing second growth forests grow to a size that precludes efficient entry into remote pine and spruce 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 or if the mountain pine beetle infestation will be halted or its impact on future lumber, chip and log prices.

Pulp and Paper Market Variability

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

Availability of Fibre and Dependency on Fibre Obtained from Government Timber Tenures

Currently, substantially all of the timberlands in BC in which we operate are owned by the Province and administered by the Ministry of Forests, Lands and Natural Resource Operations and Rural Development (the "MFLNRORD"). The Forest Act (British Columbia) (the "Forest Act") empowers the MFLNRORD to grant timber tenures, including Tree Farm Licences ("TFLs"), Forest Licences ("FLs") and Timber Licences ("TLs"), to producers, although no new TLs can be issued and the availability of extensions to expiring TLs is not assured. The Provincial Chief Forester must conduct a review of the AAC for each Timber Supply Area and each TFL in the Province on a periodic basis, at least once every ten years. This review is then used to determine the AAC for licences issued by the Province under the Forest Act. Many factors affect the AAC such as timber inventory, the amount of operable forest land, growth estimates of young forests, regulation changes and environmental and social changes. Such assessments have in the past resulted and may in the future result in reductions or increases to the AAC attributable to licences held by BC 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 government decisions regarding the public interest in designated areas. Land use planning, including critical habitat designations, stand age restrictions, as well as new harvesting regulations, can constrain access to timber and new parks can permanently remove land from the timber harvesting land base. There can be no assurance that the amounts of such future reductions on our licences, if any, will not be material or the amounts of compensation, if any, for such reductions will be fair and adequate.

Our fibre supply requirements in the United States are currently met from a broad range of sources, including Federal and State lands, from private landowners and open market purchases, which are subject to log availability and based on market prices. Changes in the log markets in which we operate, including the price, quality or availability of log supply, may increase the costs of log purchases which could adversely affect our results. In addition, weather-related issues can restrict timely access to log supply.

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. These claims of rights and title have created uncertainty as to the status of competing property rights and of legislation and Crown decisions that may adversely affect such asserted rights and title. The Supreme Court of Canada 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 agreement by the First Nation is not required in these consultations.

First Nations are seeking compensation from governments (and in some instances from forest tenure holders) with respect to these claims, and the effect of these claims on timber tenure rights, including our timber tenures, cannot be estimated at this time. The Federal and Provincial Governments have been seeking to negotiate treaty and/or other settlements with Aboriginal groups in British Columbia in order to resolve these claims.

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

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

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

Other treaty and government-to-government processes involving the 'Namgis, Ditidaht, Snuneymuxw, Heiltsuk, Hupacasath, K'ómoks, and Wuikinuxv First Nations are well advanced and may lead to agreements impacting Western in 2018. In October 2018, the Province and shíshálh Nation signed the Foundation Agreement which includes a shared-decision making process for forestry-related decisions. It is expected that through these and other settlement processes the Provincial Government may seek to remove areas from the Company's various forest tenures.

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

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

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

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

In April 2008, the Kwakiutl First Nation commenced litigation in the BC Supreme Court against the Province of British Columbia, Western and Canada, seeking, amongst other things, orders to set aside the Province's decision to remove Western's private lands from TFL 6 and the Province's approval of the Company's Forest

Stewardship Plan ("FSP") on the Crown lands within their area of interest, based on alleged infringements of their treaty rights and unextinguished aboriginal title and rights. This case was decided in June 2013, with the court upholding the Private Land withdrawal from TFL 6 and also the decision to extend the term of our FSP. The Crown was found to have an ongoing duty to consult the Kwakiutl in good faith and to seek accommodations regarding their claim of unextinguished Aboriginal rights, title and interests in respect of the Kwakiutl traditional territory. In 2015, the BC Court of Appeal ruled on the Crown's appeal of the decision, finding that the Province breached its duty to consult and owed Kwakiutl a meaningful consultation process respecting its treaty rights and claims to Aboriginal rights and title.

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.

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 MFLNRORD 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.

The current Provincial and Federal Governments have each pledged to implement the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP), the Calls to Action of the Truth and Reconciliation Commission, and, in the case of the Provincial Government, the Tsilhqot'in decision. Significant expectation has been raised among Aboriginal groups in British Columbia and across the country as to the potential impact these commitments may have on efforts to achieve true reconciliation with Aboriginal groups. To date, both the Provincial and Federal Governments have issued limited guidance as to how these commitments will be implemented, with each issuing nearly-identical principles on their respective relationship with Indigenous peoples. At this time, the Company is unable to predict the outcome of the implementation of these commitments on Western's ongoing operations or on any sale of its non-core assets and private lands.

An unfavourable result in any of the First Nations consultation or 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.

Stumpage Fees

Stumpage is the fee that the Province charges forest companies for timber harvested from Crown land in British Columbia. Approximately 95% of the timber we harvest is from Crown land. Stumpage is set using the Coast version of the Market Pricing System ("MPS"). MPS uses the winning bids and stand characteristics of timber sold through British Columbia Timber Sales ("BCTS") auctions to develop regression equations that predict the market (i.e. auction) value of Crown timber harvested under long-term tenures. The auction value is then adjusted to reflect costs that tenure holders incur and that BCTS expends on behalf of bidders. These costs, like forest planning and administration and silviculture, are referred to as 'Tenure Obligation Adjustments'. Coastal MPS are updated periodically to reflect recent sale data and costs. The most recent update occurred on December 15, 2018. Stumpage rates are also adjusted quarterly to reflect changes in log prices.

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

Long-term Fibre Supply Agreements

The Company has a number of long-term commitments to supply chip fibre, saw logs and pulp logs 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.

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.

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

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

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

In 2018, the Provincial Government introduced a Coastal Revitalization Initiative. On January 17, 2019, the Premier announced the Province’s commitment to make changes to BC’s export, Bill 13 and waste policies with the intent to increase domestic and value added manufacturing in BC. Depending on how these policy changes are implemented, they could have a material effect on our financial condition and results.

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

Information Technology Security

Western relies on information technology systems to facilitate harvesting, log purchasing and reforestation activities, operation of our manufacturing facilities, interactions with vendors, customers and employees and reporting on our business. Interruption or failure of these systems could be due to a variety of causes, such as cyber-based attacks, vandalism, power or service outages, corruption, fire or natural disaster, and could result in operational disruption or the misappropriation of sensitive or proprietary data. Such events could have a negative impact on Western’s reputation or subject the Company to potential liability, proceedings by affected parties, civil or criminal penalties. Interruption or failure of these systems could result in material adverse effect on Western’s business.

While the Company believes current security measures and disaster recovery plans to be adequate, we continue to develop and enhance internal controls, policies and procedures designed to protect information technology systems from attack, damage or unauthorized access.

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.

Continuation of the Dividend Program

We declared and paid total quarterly cash dividends of $0.0875 per outstanding common share during the four quarters ended December 31, 2018. Any decision to declare and pay dividends in the future will be made at the discretion of our Board of Directors, after taking into account our operating results, financial condition, cash requirements, financing agreement restrictions and other factors our Board may deem relevant. We may be unable or may elect not to continue to declare and pay dividends, even if necessary financial conditions are met and sufficient cash is available for distribution.

Evaluation of Disclosure Controls and Procedures

As required by National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, Western conducted an evaluation of the effectiveness of the disclosure controls and procedures and the system of internal control over financial reporting based on the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company's system of internal control over financial reporting was effective as at December 31, 2018. 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 year ended December 31, 2018.

In the year ended December 31, 2018, Western completed the implementation of inventory and payroll systems and completed the acquisition and integration of the Arlington distribution and processing centre. The Company's internal controls were maintained or supplemented by controls added during these system implementations and related process improvements.

Outstanding Share Data

As of February 12, 2019, there were 382,084,965 common shares of the Company issued and outstanding. We have reserved 30,000,000 of our Shares for issuance upon the exercise of options granted under our incentive stock option plan. During the year ended December 31, 2018, 1,235,788 options were granted, 660,000 previously granted options were exercised and 328,914 options were forfeited. As of February 12, 2019, 11,965,357 options were outstanding under our incentive stock option plan.

Additional Information

Additional information relating to the Company and its operations, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

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)		2018	Q4	Q3	Q2	Q1	2017	Q4	Q3	Q2	Q1
Average Exchange Rate – USD to CAD		**1.296**	1.322	1.307	1.291	1.265	**1.298**	1.271	1.253	1.345	1.323
Average Exchange Rate – CAD to USD		**0.771**	0.756	0.765	0.775	0.791	**0.770**	0.787	0.798	0.744	0.756
Financial Performance											
Revenue											
Lumber		**$ 952.9**	$ 230.9	$ 238.2	$ 255.6	$ 228.2	**$ 858.2**	$ 207.3	$ 212.5	$ 212.8	$ 225.6
Logs		**160.0**	36.2	33.6	49.0	41.2	**214.8**	56.6	55.5	57.2	45.5
By-products		**83.8**	17.7	20.7	23.2	22.2	**70.4**	19.2	17.2	17.4	16.6
Total revenue		**$ 1,196.7**	$ 284.8	$ 292.5	$ 327.8	$ 291.6	**$ 1,143.4**	$ 283.1	$ 285.2	$ 287.4	$ 287.7
Adjusted EBITDA		**$ 143.5**	$ 18.0	$ 32.3	$ 50.2	$ 43.0	**$ 152.6**	$ 38.9	$ 32.6	$ 47.1	$ 34.0
Adjusted EBITDA margin		**12.0%**	6.3%	11.0%	15.3%	14.7%	**13.3%**	13.7%	11.4%	16.4%	11.8%
Earnings per share:											
Net income, basic and diluted		**$ 0.18**	$ 0.02	$ 0.04	$ 0.07	$ 0.05	**$ 0.19**	$ 0.05	$ 0.04	$ 0.06	$ 0.04
Operating Statistics											
Lumber[1]											
Production	mmfbm	**864**	200	221	234	209	**793**	184	196	204	209
Shipments	mmfbm	**880**	218	212	235	215	**840**	201	220	194	225
Price	$/mfbm	**$ 1,083**	$ 1,059	$ 1,124	$ 1,088	$ 1,061	**$ 1,022**	$ 1,031	$ 966	$ 1,097	$ 1,003
Logs[2]											
Net production	000 m^3	**4,328**	1,135	815	1,348	1,029	**4,008**	1,099	910	1,091	908
Saw log purchases	000 m^3	**979**	212	197	305	265	**1,150**	343	327	249	231
Log availability	000 m^3	**5,307**	1,347	1,012	1,653	1,294	**5,158**	1,442	1,237	1,340	1,139
Shipments	000 m^3	**1,509**	369	308	471	361	**1,663**	494	369	436	364
Price[3]	$/$m^3$	**$ 106**	$ 98	$ 109	$ 104	$ 114	**$ 120**	$ 107	$ 134	$ 122	$ 116
Share Repurchases and Dividends											
Shares repurchased (millions)		**11.7**	4.9	4.6	1.6	0.6	**1.1**	1.1	-	-	-
Shares repurchased		**$ 25.2**	$ 9.1	$ 10.4	$ 4.1	$ 1.6	**$ 2.7**	$ 2.7	$ -	$ -	$ -
Dividends paid		**$ 34.3**	$ 8.7	$ 8.8	$ 8.9	$ 7.9	**$ 31.7**	$ 7.9	$ 7.9	$ 7.9	$ 7.9

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

(1) "mmfbm" = millions of board feet; "mfbm" = thousands of board feet.
(2) Net production is sorted log production, net of residuals and waste. Log availability is net production plus saw log purchases.
(3) The log revenue used to determine average price per cubic metre has been reduced by the associated shipping costs arranged in the respective periods to enable comparability of unit prices.

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

Western Forest Products Inc.
DEFINING A HIGHER STANDARD™

CONSOLIDATED FINANCIAL STATEMENTS

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 Consolidated Financial Statements have been prepared by Management in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and, where necessary, reflect Management's best estimates and judgements at this time. The financial information presented throughout the Management's Discussion and Analysis dated February 12, 2019 is consistent with that contained in the Consolidated Financial Statements.

Western maintains systems of internal accounting controls, policies and procedures to provide reasonable assurance 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, procedures and controls, and employment of an internal audit program.

The Board of Directors reviews through oversight of 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.

"Don Demens"

Don Demens
President & Chief Executive Officer

"Stephen Williams"

Stephen Williams
Executive Vice President & Chief Financial Officer

February 12, 2019

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Western Forest Products Inc.

Opinion

We have audited the consolidated financial statements of Western Forest Products Inc. (the "Company"), which comprise:

- the consolidated statements of financial position as at end of December 31, 2018 and December 31, 2017
- the consolidated statements of comprehensive income for the years then ended
- the consolidated statements of changes in shareholders' equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Company as at end of December 31, 2018 and end of December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the **"*Auditors' Responsibilities for the Audit of the Financial Statements*"** section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to or audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

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

Other Information

Management is responsible for the other information. Other information comprises:

- Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.
- Information, other than the financial statements and the auditors' report thereon, included in a document likely to be entitled "Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis and the Annual Report filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

KPMG LLP

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is John Desjardins.

Vancouver, Canada
February 12, 2019

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

	December 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 8.4	$ 35.3
Trade and other receivables (Note 19)	91.3	86.2
Inventory (Note 4)	174.9	152.0
Prepaid expenses and other assets	23.3	19.0
	297.9	292.5
Non-current assets:		
Property, plant and equipment (Note 5)	369.9	313.9
Timber licenses (Note 6)	113.2	117.2
Biological assets (Note 7)	58.3	58.2
Other assets (Note 8)	15.8	17.5
Deferred income tax assets (Note 10)	0.7	0.3
	$ 855.8	$ 799.6
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 132.7	$ 98.9
Reforestation obligation (Note 12)	10.0	8.9
	142.7	107.8
Non-current liabilities:		
Long-term debt (Note 9)	6.0	-
Reforestation obligation (Note 12)	15.7	16.4
Deferred income tax liabilities (Note 10)	40.3	28.1
Other liabilities (Note 11)	23.8	28.2
Deferred revenue (Note 17(d), 23)	54.4	56.4
	282.9	236.9
Shareholders' equity:		
Share capital (Note 13)	491.1	505.5
Contributed surplus	9.1	8.7
Retained earnings	72.7	48.5
	572.9	562.7
	$ 855.8	$ 799.6

Commitments and Contingencies (Note 17)
Subsequent event (Note 26)
See accompanying notes to these consolidated financial statements.

Approved on behalf of the Board:

"Lee Doney"
Chairman

"James Arthurs"
Director

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

	Years ended December 31, 2018	Years ended December 31, 2017
Revenue (Note 23)	$ 1,196.7	$ 1,143.4
Costs and expenses:		
Cost of goods sold	927.7	874.6
Freight	90.6	103.2
Export tax (Note 17)	43.0	15.8
Selling and administration	32.0	32.8
	1,093.3	1,026.4
Operating income prior to restructuring items and other expense	103.4	117.0
Operating restructuring items (Note 21)	(4.8)	(14.4)
Other income (expense)	(1.1)	1.2
Operating income	97.5	103.8
Finance costs (Note 20)	(2.7)	(2.5)
Income before income taxes	94.8	101.3
Current income tax expense (Note 10)	(14.3)	(0.2)
Deferred income tax expense (Note 10)	(11.3)	(26.7)
	(25.6)	(26.9)
Net income	69.2	74.4
Other comprehensive loss		
Items that will not be reclassified to profit or loss:		
Defined benefit plan actuarial loss (Note 18)	(0.7)	(1.5)
Income tax recovery on other comprehensive loss (Note 10)	0.2	0.7
Total items that will not be reclassified to profit or loss	(0.5)	(0.8)
Other comprehensive loss for the period	(0.5)	(0.8)
Total comprehensive income	$ 68.7	$ 73.6
Net income per share (in dollars)		
Basic and diluted earnings per share (Note 15)	$ 0.18	$ 0.19
Weighted average number of common shares outstanding (thousands)		
Basic	392,333	395,589
Diluted	396,107	399,663

See accompanying notes to these consolidated financial statements.

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

	Share Capital	Contributed Surplus	Retained Earnings	**Total Equity**
Balance at December 31, 2016	$ 506.0	$ 8.6	$ 7.9	$ 522.5
Net income	-	-	74.4	74.4
Other comprehensive loss:				
Defined benefit plan actuarial loss recognized	-	-	(1.5)	(1.5)
Income tax recovery on other comprehensive loss	-	-	0.7	0.7
Total comprehensive income	-	-	73.6	73.6
Share-based payment transactions recognized in equity	-	0.4	-	0.4
Exercise of stock options	0.9	(0.3)	-	0.6
Repurchase of shares (Note 13)	(1.4)	-	(1.3)	(2.7)
Dividends	-	-	(31.7)	(31.7)
Total transactions with owners, recorded directly in equity	(0.5)	0.1	(33.0)	(33.4)
Balance at December 31, 2017	$ 505.5	$ 8.7	$ 48.5	$ 562.7

	Share Capital	Contributed Surplus	Retained Earnings	**Total Equity**
Balance at December 31, 2017	$ 505.5	$ 8.7	$ 48.5	$ 562.7
Net income	-	-	69.2	69.2
Other comprehensive loss:				
Defined benefit plan actuarial loss recognized	-	-	(0.7)	(0.7)
Income tax recovery on other comprehensive loss	-	-	0.2	0.2
Total comprehensive income	-	-	68.7	68.7
Share-based payment transactions recognized in equity (Note 14(a))	-	0.8	-	0.8
Exercise of stock options	0.6	(0.4)	-	0.2
Repurchase of shares (Note 13)	(15.0)	-	(10.2)	(25.2)
Dividends (Note 13)	-	-	(34.3)	(34.3)
Total transactions with owners, recorded directly in equity	(14.4)	0.4	(44.5)	(58.5)
Balance at December 31, 2018	$ 491.1	$ 9.1	$ 72.7	$ 572.9

See accompanying notes to these consolidated financial statements.

Western Forest Products Inc.
Consolidated Statements of Cash Flows
(Expressed in millions of Canadian dollars)

	Years ended December 31, 2018	Years ended December 31, 2017
Cash provided by (used in):		
Operating activities:		
Net income	$ 69.2	$ 74.4
Items not involving cash:		
Amortization of property, plant and equipment (Note 5)	36.2	32.3
Amortization of timber licenses (Note 6)	4.0	4.0
Gain on disposal of assets	(0.5)	(3.8)
Impairment of assets	0.3	3.2
Change in fair value of biological assets (Note 7)	(0.1)	(0.6)
Change in reforestation obligation (Note 12)	0.4	(3.6)
Amortization of deferred revenue	(2.0)	(2.0)
Share-based compensation, including mark-to-market adjustment	1.7	4.4
Net finance costs	2.7	2.5
Income tax expense (Note 10)	25.6	26.9
Change in pension liability (Note 18)	(3.1)	(3.2)
Export tax receivable (Note 17)	(0.3)	(3.5)
Other	(1.1)	(2.2)
	133.0	128.8
Changes in non-cash working capital items:		
Trade and other receivables	(5.2)	20.8
Inventory	(22.9)	(2.7)
Prepaid expenses and other assets	(4.3)	(4.8)
Accounts payable and accrued liabilities	17.6	(7.7)
	(14.8)	5.6
	118.2	134.4
Investing activities:		
Additions to property, plant and equipment (Note 5)	(83.5)	(55.2)
Purchase of Arlington facility (Note 5)	(11.6)	-
Proceeds on disposal of assets	3.1	7.7
Deposits (Note 5)	-	(0.6)
	(92.0)	(48.1)
Financing activities:		
Interest paid	(1.0)	(1.2)
Draw on long-term debt (Note 9)	7.0	-
Repayment of long-term debt	-	(35.0)
Repurchase of shares (Note 13)	(25.2)	(2.7)
Dividends (Note 13)	(34.3)	(31.7)
Proceeds from exercise of stock options	0.4	0.6
	(53.1)	(70.0)
Increase (decrease) in cash and cash equivalents	(26.9)	16.3
Cash and cash equivalents, beginning of year	35.3	19.0
Cash and cash equivalents, end of year	$ 8.4	$ 35.3

See accompanying notes to these consolidated financial statements.

1. Reporting entity

Western Forest Products Inc. ("Western" or the "Company") is an integrated forest products company, incorporated and domiciled in Canada, operating primarily on the coast of British Columbia and Washington State. The address of the Company's head office is Suite 800 – 1055 West Georgia Street, Vancouver, British Columbia, Canada. The consolidated financial statements as at and for the years ended December 31, 2018 and 2017 comprise the financial results of the Company and its subsidiaries. The Company's primary business is the sale of lumber and logs, which includes timber harvesting, sawmilling logs into specialty lumber and value-added lumber remanufacturing. The Company is listed on the Toronto Stock Exchange, under the symbol WEF.

2. Basis of preparation

(a) Statement of compliance

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board. Certain comparative figures in the statements of cash flows have been reclassified to conform to the current year's presentation.

The consolidated financial statements were authorized for issue by the Board of Directors on February 12, 2019.

(b) Basis of measurement

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

- Biological assets are measured at fair value less costs to sell;
- Liabilities for cash-settled share-based payment transactions are measured at fair value at each reporting date;
- Equity-settled share-based payments are measured at fair value at grant date;
- Derivative financial instruments are measured at fair value through profit or loss at each reporting date;
- The defined benefit pension liability is recognized as the net total of the fair value of the plan assets, less the present value of the defined benefit obligation; and,
- Reforestation obligations are measured at the discounted value of expected future cash flows.

(c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars which is the Company's functional currency. All amounts are presented in millions of Canadian dollars, unless otherwise indicated.

(d) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by Western. Western controls an entity when it is exposed to, or has rights to, variable returns from its investment with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which it ceases.

The principal wholly-owned operating subsidiaries of the Company at December 31, 2018 are Western Lumber Sales Limited, which sells into the United States ("US"), Western Forest Products Japan Ltd., which sells into Japan and WFP Partnerships Ltd, which holds assets of the US operation through indirect US subsidiaries, including Western Forest Products US LLC.

(ii) Interests in equity-accounted investees

Western's interests in equity-accounted investees comprise interests in joint ventures. A joint venture is an arrangement in which Western has joint control, whereby it has the rights to the net assets of the arrangement, rather than rights to all of its assets and obligations for all of its liabilities.

2. Basis of preparation (continued)

(d) Basis of consolidation (continued)

(ii) Interests in equity-accounted investees (continued)

Interests in the joint venture are accounted for using the equity method. They are recognized initially at cost, including transaction costs. Subsequent to initial recognition, the consolidated financial statements include Western's share of the profit and loss and other comprehensive income of equity accounted investees, until the date on which significant influence or joint control ceases.

(iii) Transactions eliminated on consolidation

Inter-company balances and transactions, and any unrealized income and expenses arising from inter-company transactions, are eliminated. Unrealized gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of Western's interest in the investee. Unrealized losses are eliminated in the same way, except to the extent that there is evidence of impairment.

(e) Foreign currency translation

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

(f) Use of estimates and judgements

The preparation of the consolidated financial statements in conformity with IFRS requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

(i) Judgements

The determination of appropriate cash generating units as described in Note 3(b) is a judgement made in applying accounting policy that has a significant effect on the amounts recognized in the consolidated financial statements.

(ii) Assumptions and estimation uncertainties

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

Note 4	Measurement of net realizable value of inventories
Note 7	Measurement of fair value less costs to sell of standing timber
Note 10	Recognition of deferred income tax assets: availability of future taxable profit against which carry forward tax losses can be used
Note 12	Measurement of the present value of reforestation obligations: key assumptions about the likelihood and magnitude of an outflow of resources
Note 14	Measurement of share-based payment transactions
Note 17	Recognition and measurement of provisions and contingencies: key assumptions about the likelihood and magnitude of an outflow of resources
Note 19	Measurement of defined benefit obligations, key actuarial assumptions, recognition of termination benefits

Measurement of fair values – a number of Western's accounting policies and disclosures require the measurement of fair values for both financial and non-financial assets and liabilities. An established framework is in place with respect to the measurement of fair values, including Level 3

2. Basis of preparation (continued)

(f) *Use of estimates and judgements (continued)*

(ii) *Assumptions and estimation uncertainties (continued)*

fair values, on which significant unobservable inputs and valuation adjustments are reviewed regularly. third party information is used to measure fair values, Management assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations would be classified. Refer to Note 19 for more details.

When measuring the fair value of an asset or liability, Western uses market observable data as far as is possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

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

If the inputs to measure the fair value of the asset or liability might be categorized in different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the hierarchy as the lowest level input that is significant to the entire measurement. Transfers between levels of the fair value hierarchy are recognized at the end of the period in which the change occurred.

The Company does not include WorkSafeBC Certificate of Recognition ("COR") rebates when estimating its WorkSafeBC insurance premium expense, as the collectability of COR rebates cannot be reasonably assured. During the year ended December 31, 2017, the Company recognized a reduction to cost of goods sold of $3.1 million for the receipt of COR rebates arising from fiscal years 2014 and 2016.

(g) *Accounting standards not yet adopted*

The following amended IFRS standard is not yet effective for the year ended December 31, 2018 and has not been applied in preparing these consolidated financial statements.

IFRS 16, Leases ("IFRS 16")

IFRS 16 is effective for years commencing on or after January 1, 2019, and will replace IAS 17, *Leases* ("IAS 17"). IFRS 16 provides a single lessee accounting model, requiring the recognition of assets and liabilities for all leases, unless the lease term is 12 months or less or the underlying asset has a low value, while lessor accounting remains largely unchanged from IAS 17 and the distinction between operating and finance leases is retained. The Company intends to adopt IFRS 16 in its consolidated financial statements for the year commencing January 1, 2019.

The Company plans to apply a modified retrospective approach upon adoption of IFRS 16. Under the modified retrospective approach, the Company will calculate the right of use assets and lease liabilities as at January 1, 2019 and will not restate comparative information. The Company will recognize the cumulative effect of initially applying the standard as an adjustment to equity at the date of application. The Company continues to evaluate the impact of adopting the new standard which will be completed and disclosed in the consolidated financial statements in the first quarter of 2019. The Company anticipates that upon transition, the impact to its consolidated financial statements will be an increase in non-current assets and liabilities of less than 3% of total assets. Following the adoption of this standard, the consolidated statement of comprehensive income will recognize depreciation in cost of goods sold and finance costs for operating lease payments previously expensed in cost of goods sold.

The Company's future minimum lease payments at December 31, 2018 under operating leases are disclosed in Note 17 (e).

3. Significant accounting policies

Significant accounting policies not described elsewhere in these consolidated financial statements include:

(a) 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 amortized cost.

(b) Impairment of non-financial assets

At each reporting date, the Company reviews the carrying amounts of its non-financial assets (other than biological assets, inventories, and deferred income tax assets) to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or cash generating units ("CGUs"). The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. Value in use is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

Impairment losses are recognized in net income. They are allocated first to reduce the carrying amount of goodwill (if any) to the CGU, and then to reduce the carrying amounts of the other assets in the CGU on a pro-rata basis. An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

4. Inventory

Accounting policy

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

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

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

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

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

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

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

Due to increased variability in logging stumpage costs, the Company changed its log inventory costing methodology to allocate stumpage expense to sorted log production volume based on a relative sorted value, by operation. The change was made prospectively as the impact on prior periods was not material.

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

4. Inventory (continued)

Supporting information

	December 31, 2018	December 31, 2017
Gross value of inventory		
Logs	$ 125.7	$ 109.5
Lumber	51.7	36.8
Supplies and other	13.1	14.1
	$ 190.5	$ 160.4
Provisions		
Logs	$ (8.8)	$ (5.7)
Lumber	(6.3)	(2.2)
Supplies and other	(0.5)	(0.5)
	$ (15.6)	$ (8.4)
Total value of inventory	$ 174.9	$ 152.0

The carrying amount of inventory recorded at net realizable value was $79.4 million at December 31, 2018 (2017: $51.3 million), with the remaining inventory recorded at cost.

During 2018, $927.7 million (2017: $874.6 million) of inventory was charged to cost of sales which includes a $7.2 million increase (2017: $5.6 million decrease) to the provision relating to inventory value write-downs.

5. Property, plant and equipment

Accounting policy

All items of property, plant and equipment are measured at cost, less accumulated depreciation and any accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

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

- Buildings and equipment 5 - 20 years
- Long-term logging roads and bridges 9 - 20 years

Residual values, depreciation methods and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

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

Supporting information

On January 17, 2018, the Company completed the acquisition of the assets of a lumber distribution and processing centre in Arlington, Washington for a total purchase price, including related transaction costs, of $11.6 million. A purchase deposit of US $0.5 million was recorded to other assets at December 31, 2017.

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

5. Property, plant and equipment (continued)

Cost	Buildings & equipment	Logging roads	Land	Total
Balance at January 1, 2017	$ 302.8	$ 178.4	$ 90.6	$ 571.8
Additions	41.7	13.5	-	55.2
Disposals	(2.6)	-	(2.8)	(5.4)
Balance at December 31, 2017	341.9	191.9	87.8	621.6
Additions	70.6	12.9	-	83.5
Arlington facility	7.9	-	3.7	11.6
Disposals	(6.7)	-	(2.3)	(9.0)
Balance at December 31, 2018	$ 413.7	$ 204.8	$ 89.2	$ 707.7
Accumulated amortization and impairments				
Balance at January 1, 2017	$ 130.1	$ 144.5	$ -	$ 274.6
Amortization	20.0	12.3	-	32.3
Disposals	(2.0)	-	-	(2.0)
Impairments	2.7	-	0.1	2.8
Balance at December 31, 2017	150.8	156.8	0.1	307.7
Amortization	23.0	13.2	-	36.2
Disposals	(6.4)	-	-	(6.4)
Impairments	0.1	-	0.2	0.3
Balance at December 31, 2018	$ 167.5	$ 170.0	$ 0.3	$ 337.8
Carrying amounts				
At December 31, 2017	$ 191.1	$ 35.1	$ 87.7	$ 313.9
At December 31, 2018	$ 246.2	$ 34.8	$ 88.9	$ 369.9

6. Timber licences

Accounting policy

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

Supporting information

Cost	
Balance at December 31, 2017	$ 170.7
Balance at December 31, 2018	$ 170.7
Accumulated amortization	
Balance at January 1, 2017	$ 49.5
Amortization	4.0
Balance at December 31, 2017	$ 53.5
Amortization	4.0
Balance at December 31, 2018	$ 57.5
Carrying amounts	
At December 31, 2017	$ 117.2
At December 31, 2018	$ 113.2

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

7. Biological assets

Accounting policy

Standing timber on privately held forest land that is managed for timber production is characterized as a biological asset. Accordingly, at each reporting date, the biological asset is valued at its fair value less costs to sell with any change therein, including the impact of growth and harvest, recognized in net income for the period. Costs to sell include all costs that would be necessary to sell the assets. Land under the standing timber is measured at cost and included in property, plant and equipment. Long-term roads and bridges on the land underlying the standing timber are considered a component of property, plant and equipment and are recorded at cost less accumulated amortization.

Supporting information

(a) Reconciliation of carrying amount

	Years ended December 31, 2018	2017
Carrying value, beginning of year	$ 58.2	$ 57.6
Change in fair value due to growth and pricing	5.6	5.6
Harvested timber transferred to inventory	(5.5)	(5.0)
Carrying value, end of year	$ 58.3	$ 58.2

At December 31, 2018, private timberlands comprised an area of approximately 23,293 hectares (December 31, 2017: 23,293 hectares) of land owned by the Company; standing timber on these timberlands ranged from newly planted cut-blocks to mature forests available for harvest. During the year ended December 31, 2018, the Company harvested and scaled approximately 141,609 cubic metres (“m^3”) of logs from its private timberlands, which had a fair value less costs to sell of $106 per m^3 at the date of harvest (2017: 127,844 m^3 and $112 per m^3, respectively).

(b) Measurement of fair values

The table above reconciles the opening balances to the closing balances for Level 3 fair values. The change in fair value resulting from price and growth is reflected in cost of goods sold. The fair value measurements for the Company’s standing timber of $58.3 million has been categorized as Level 3 fair value based on the inputs to the valuation technique used as discussed below.

Valuation technique	Significant unobservable inputs	Inter-relationship between key unobservable inputs and fair value measurement
Discounted cash flows*:* The valuation model considers the present value of the net cash flows expected to be generated by the individual private timberlands utilizing a harvest optimization approach. The cash flow projections include specific estimates for 25 years. The expected net cash flows are discounted using a risk-adjusted discount rate.	• Estimated future log prices per m^3 ($74 - $152, weighted average $96). • Estimated harvest costs per m^3 ($59 - $81, weighted average $64). • Estimated harvest annual volume (11,000 - 108,000 m^3, weighted average 88,000 m^3). • Risk-adjusted discount rate (2017: 7.0% - 7.5%, weighted average 7.0%	The estimated fair value would increase (decrease) if: • The estimated log prices per m^3 were higher (lower); • The estimated harvest costs per m^3 were lower (higher); • The estimated harvest volumes were higher (lower); or • The risk-adjusted discount rates were lower (higher).

(c) Risk management strategies related to biological assets

Western is exposed to the following risks relating to its private timberlands:

- The Company is exposed to risks arising from fluctuations in log prices and sales volumes. When possible, Western aligns its harvest volumes to market supply and demand, and performs regular industry trend analyses for projected harvest volumes and pricing in order to manage this risk.
- The standing timber is exposed to risk of damage as a result of severe weather conditions, forest fires, insect infestation and disease. Western has processes and procedures in place to monitor and mitigate these risks, including fire management strategies and regular inspection for pest infestation.

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

8. Other assets

	December 31, 2018	December 31, 2017
Investments	$ 11.1	$ 13.3
Deferred transaction costs	0.9	0.7
Export tax receivables (Note 17(b))	3.8	3.5
	$ 15.8	$ 17.5

9. Long-term debt

Accounting policy

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

Transaction costs are deferred and amortized to finance costs over the term of the long-term debt using the effective interest rate method.

Supporting information

On August 8, 2018, the Company entered into a new syndicated Credit Facility (the “Credit Facility”). The Credit Facility provides for a maximum borrowing amount of $250 million, has a maturity date of August 1, 2022, and includes an accordion feature which allows the Company to increase the aggregate amount available to $350 million, subject to lender approval.

The Credit Facility is available in Canadian dollars by way of Prime Rate Advances, Bankers’ Acceptances or Letters of Credit and in US dollars by way of US Base Rate Advances, US Prime Rate Advances, LIBOR Advances or Letters of Credit. Interest on the Credit Facility is indexed to benchmark rates and varies depending on the nature of each draw and a total debt to EBITDA based pricing grid.

The Credit Facility is secured by a general security agreement, excluding specified properties and their related assets, and is subject to certain financial covenants, including maximum debt to total capitalization ratios (see Note 16).

At December 31, 2018, $7.0 million was outstanding under the Company’s Credit Facility. The interest rate for the Credit Facility was 4.65% at December 31, 2018. The Company was in compliance with its financial covenants at December 31, 2018.

	December 31, 2018	December 31, 2017
Long-term debt	$ 7.0	$ -
Less transaction costs	(1.0)	-
	$ 6.0	$ -
Available	$ 250.0	$ 110.0
Drawings	(7.0)	-
Outstanding letters of credit	(1.0)	-
Unused portion of Term Loan	$ 242.0	$ 110.0

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

10. Income taxes

Accounting policy

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

(a) Current tax

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to tax payable or receivable in respect of the previous years. It is measured using tax rates enacted or substantively enacted at the reporting date.

Current income tax assets and liabilities are offset only if certain criteria are met.

(b) Deferred income tax

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

Deferred income tax assets are recognized for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred income tax assets are reviewed at each reporting date and are recognized to the extent that it is probable that the related tax benefit will be realized. Unrecognized deferred income tax assets are reassessed at each reporting date and recognized to the extent that it is probable that future taxable profits will be available against which they can be used.

Deferred income tax is measured at the rates that are expected to be applied to temporary differences when they reverse, using rates enacted or substantively enacted at the reporting date. Deferred income tax assets and liabilities are offset only if certain criteria are met.

Supporting information

	Years ended December 31,	
	2018	2017
Current tax expense		
Current period	$ 14.3	$ 0.2
	$ 14.3	$ 0.2
Deferred income tax expense		
Origination and reversal of temporary differences	$ 11.3	$ 26.0
Change in tax rates	-	0.8
Recognition of previously unrecognized tax losses	-	-
Change in unrecognized deductible temporary differences	-	(0.1)
	$ 11.3	$ 26.7
Total income tax expense	$ 25.6	$ 26.9

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

10. Income taxes (continued)

(b) Deferred income tax (continued)

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

	Years ended December 31, 2018	2017
Income tax expense at the statutory rate of 27.00% (2017 - 26.00%)	$ 25.6	$ 26.3
Difference in tax rates	0.2	(0.3)
Over (under) provided for in prior periods	0.2	(0.3)
Other permanent differences	-	0.2
Change in income tax rates	-	0.8
Use of investment tax credits	(0.4)	-
Change in unrecognized deductible temporary differences	-	0.2
Total income tax expense - 27.10% (2017 - 26.55%)	$ 25.6	$ 26.9

The statutory rate increased from 26% to 27% effective January 1, 2018.

The components of recognized deferred income tax assets and liabilities are as follows:

	Opening Balance	Recognized in Profit or Loss	Recognized in Taxes Payable	Recognized in OCI	Ending Balance
For the Year ended December 31, 2018					
Deferred income tax assets					
Tax loss carry-forwards	$ 11.9	$ (10.9)	$ -	$ -	$ 1.0
Employee future benefits obligation	6.0	(0.8)	-	0.2	5.4
Provisions and other	12.9	2.0	(0.7)	-	14.2
	30.8	(9.7)	(0.7)	0.2	20.6
Deferred income tax liabilities					
Intangible assets	(31.6)	1.1	-	-	(30.5)
Biological assets	(8.5)	(0.1)	-	-	(8.6)
Property, plant and equipment	(18.5)	(2.6)	-	-	(21.1)
	(58.6)	(1.6)	-	-	(60.2)
	$ (27.8)	$ (11.3)	$ (0.7)	$ 0.2	$ (39.6)
For the Year ended December 31, 2017					
Deferred income tax assets					
Tax loss carry-forwards	$ 30.9	$ (19.0)	$ -	$ -	$ 11.9
Employee future benefits obligation	6.3	(1.0)	$ -	0.7	6.0
Provisions and other	12.7	0.2	-	-	12.9
	49.9	(19.8)	-	0.7	30.8
Deferred income tax liabilities					
Intangible assets	(31.5)	(0.1)	-	-	(31.6)
Biological assets	(7.9)	(0.6)	-	-	(8.5)
Property, plant and equipment	(12.3)	(6.2)	-	-	(18.5)
	(51.7)	(6.9)	-	-	(58.6)
	$ (1.8)	$ (26.7)	$ -	$ 0.7	$ (27.8)

The Company has recognized deferred income tax assets in relation to unused tax losses that are available to carry forward against future taxable income. At December 31, 2018, the Company and its subsidiaries have unused non-capital tax losses carried forward totaling $2.1 million in the US (2017: nil) and $2.0 million in Canada (2017: $43.9 million), which can be used to reduce taxable income. The Company has unused capital losses carried forward of approximately $93.7 million (2017: $96.3 million) available to be utilized against future capital gains indefinitely.

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

10. Income taxes (continued)

(b) Deferred income tax (continued)

Deferred income tax assets have not been recognized in respect of the following loss carry-forwards and other deductible temporary differences:

	December 31, 2018	December 31, 2017
Temporary deductible differences	$ 19.0	$ 16.8
Capital loss carry-forwards	93.7	96.3
	$ 112.7	$ 113.1

11. Other liabilities

	December 31, 2018	December 31, 2017
Employee future benefits obligation (Note 18)	$ 19.0	$ 21.4
Environmental accruals	1.5	3.1
Performance share unit plan liabilities, non-current (Note 14(c))	1.8	2.5
Other	1.5	1.2
	$ 23.8	$ 28.2

12. Reforestation obligation

Accounting policy

The Company's provision for reforestation relates to the obligation for reforestation on Crown land and arises as timber is harvested. Reforestation on private timberlands is expensed as incurred. The Company recognizes a provision for reforestation at fair value in the period in which the legal obligation is incurred, with the fair value of the liability at the reporting date determined with reference to the present value of estimated future cash flows. The pre-tax discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability. The actual discount rate used reflects the current risk-free rate given that risks are incorporated into the future cash flow estimates.

In periods subsequent to the initial measurement, changes in the liability resulting from revisions to estimated future costs are recognized in cost of sales within net income for the period as they occur. Reforestation expense incurred on current production is included in production costs and the unwinding of discount, or accretion cost, is included in finance costs for the year.

Supporting information

Changes in the reforestation obligation are as follows:

	Years ended December 31,	
	2018	2017
Reforestation obligation, beginning of period	$ 25.3	$ 28.9
Reforestation provision charged	8.6	5.4
Reforestation expenditures	(8.5)	(9.3)
Unwind of discount	0.3	0.3
Reforestation obligation, end of period	25.7	25.3
Less current portion	10.0	8.9
	$ 15.7	$ 16.4

The reforestation expenditures are expected to occur over the next one to ten years and have been discounted at risk-free rates of 1.86% to 1.97% (2017: 1.52% to 2.05%). The total undiscounted amount of the estimated future expenditures required to settle the reforestation obligation at December 31, 2018 is $26.7 million (December 31, 2017: $26.4 million).

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

13. Share capital

Accounting policy

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

Supporting information

The Company has no outstanding preferred shares. The common shares entitle the holders thereof to one vote per share. Issued and outstanding common shares are as follows:

	Number of Common Shares		Amount
Balance at January 1, 2017	395,447,663	$	506.0
Exercise of stock options	407,429		0.9
Repurchase of shares	(1,079,000)		(1.4)
Balance at December 31, 2017	394,776,092	$	505.5
Exercise of stock options	660,000		0.6
Repurchase of shares	(11,695,573)		(15.0)
Balance at December 31, 2018*	383,740,519	$	491.1

*Based on trade date

During the year ended December 31, 2018, cash dividends of $0.02 per common share were paid for the quarter ended March 31, 2018, and $0.0225 for each of the quarters ended June 30, 2018, September 30, 2018 and December 31, 2018. An aggregate of $34.3 million (2017: $31.7 million) in dividends was paid to shareholders in 2018.

On August 3, 2018, the Company renewed a Normal Course Issuer Bid ("NCIB") permitting the purchase and cancellation up to 19,662,439 of the common shares or approximately 5% of the common shares issued and outstanding as of August 3, 2018. The NCIB expires on August 7, 2019.

In 2018, the Company repurchased 11,695,573 common shares under the NCIB (2017: 1,079,000) for $25.2 million at an average price of $2.15 per common share (2017: $2.7 million and $2.50, respectively), of which $15.0 million was charged to share capital and $10.2 million was charged to retained earnings (2017: $1.4 million and $1.3 million, respectively).

14. Share-based compensation plans

Accounting policy

Stock options

The Company has established an incentive stock option plan (the "Option Plan") for eligible directors, officers and employees and accounts for these plans using the fair value method. The grant-date fair value of options is recognized as an employee expense, with a corresponding increase in contributed surplus, over the period that the individual becomes unconditionally entitled to the awards. When stock options are exercised, the cash consideration received from employees is credited to share capital, as is the previously calculated fair value included in contributed surplus.

Determining the fair value of share-based compensation awards at the grant date requires judgement. The fair value of the options is determined using either the Black-Scholes or the Hull-White option pricing models which take into account, as of the grant date, the exercise price, the expected life of the options, the current price of the underlying stock and its expected volatility, expected dividends on the shares, and the risk-free interest rate over the expected life of the option. The Company bases its estimates of volatility on historical share prices of the Company itself as well as those of comparable companies with longer trading histories.

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 this model takes into account the barrier price factor.

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

14. Share-based compensation plans (continued)

Deferred share units and performance share units

The grant-date fair value of the amount payable to eligible directors, officers and employees in respect of Deferred Share Units ("DSUs"), which are cash-settled, is recognized as an employee expense with a corresponding increase in liabilities, over the period that the individuals become unconditionally entitled to payment.

The grant-date fair value of the amount payable to eligible officers and employees in respect of Performance Share Units ("PSUs"), which are cash-settled, is recognized as an employee expense with a corresponding increase in liabilities, over a three year performance period.

The liabilities under the DSU and PSU Plans are re-measured at fair value at each reporting date and at settlement date. For the PSU Plan, this includes re-measurement as the Company's performance tracks against the performance vesting targets. Any changes in the fair value of the liabilities are recognized in cost of goods sold and selling and administration expense.

Supporting information

(a) Stock-option plan

The Option Plan permits the granting of options to eligible participants to purchase up to an aggregate of 30,000,000 common shares. Each option is exercisable, subject to vesting terms of 20% per year and immediately upon a change in control of the Company, into one Common Share, subject to adjustments, at a price of not less than the closing price of the common shares on the TSX on the day immediately preceding the grant date. Options granted under the Option Plan expire a maximum of ten years from the date of the grant. All outstanding options are only exercisable when the share price has been equal to or exceeds $0.70 for the 60 consecutive days preceding the date of exercise on a volume weighted average price basis.

During the year ended December 31, 2018, the Company granted 1,235,788 options with a fair value of $0.9 million. Weighted average assumptions applied in the option pricing model included exercise price of $2.74, risk-free interest rate of 2.28%, a volatility rate of 33.81%, and an expected life of seven years.

The following table summarizes the change in options outstanding during the years ended December 31, 2018 and 2017:

	Years ended December 31, 2018		Years ended December 31, 2017	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Outstanding, beginning of period	11,718,483	$ 1.56	11,235,585	$ 1.50
Granted	1,235,788	$ 2.74	1,657,877	$ 2.09
Exercised	(660,000)	$ 0.59	(426,226)	$ 1.40
Forfeited	(328,914)	$ 2.13	(748,753)	$ 1.99
Outstanding, end of period	11,965,357	$ 1.72	11,718,483	$ 1.56

Details of options outstanding under the Option Plan at December 31, 2018 are as follows:

Exercise price	Number outstanding December 31, 2018	Weighted average remaining option life (years)	Weighted average exercise price	Number exercisable December 31, 2017	Weighted average exercise price
$0.22 - $0.96	3,850,000	2.9	$ 0.82	3,850,000	$ 0.82
$1.27 - $1.97	2,537,654	5.5	$ 1.58	1,855,062	$ 1.44
$2.09 - $2.75	5,577,703	7.1	$ 2.39	2,361,821	$ 2.38
	11,965,357	5.4	$ 1.72	8,066,883	$ 1.42

In 2018, the Company recorded equity-based compensation expense for these options of $0.8 million (2017: expense of $0.4 million), with a corresponding increase to contributed surplus.

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

14. Share-based compensation plans (continued)

(b) Deferred share unit plan

The Company has a DSU Plan for directors and designated executive officers. Directors may elect to take a portion of their fees in the form of DSUs and prior to January 1, 2015 executive officers could elect to take a portion of their annual incentive bonus in the form of DSUs. For directors, the number of DSUs allotted is determined by dividing the dollar portion of the quarterly fees a director elects to take in DSUs by the share price value on the fifth day following each quarter end. All DSU holders are entitled to DSU dividends, equivalent to the dividend they would have received if they held their DSUs as common shares. For dividends, the number of DSUs allotted is determined by dividing the total dollar value of the dividend each DSU holder would have received, by the closing share price on the dividend payment date.

Effective January 1, 2015, DSUs are only granted to non-executive directors per the amended DSU Plan.

	Years ended December 31, 2018		Years ended December 31, 2017	
	Number of DSU	Weighted average unit value	Number of DSU	Weighted average unit value
Outstanding, beginning of period	1,282,219	$ 1.18	1,100,073	$ 0.98
Granted	186,535	$ 2.32	182,146	$ 2.39
Outstanding, end of period	1,468,754	$ 1.32	1,282,219	$ 1.18

In 2018, the Company recorded equity-based compensation recovery for these DSUs of $0.6 million (2017: expense of $1.1 million), with a corresponding decrease to accounts payable and accrued liabilities.

(c) Performance share unit plan

The Company has established a PSU Plan for designated officers and employees of the Company. Under the terms of the PSU Plan, participants are granted a number of PSUs based on a target award divided by the value of the Company's common shares at the effective date of grant. All PSU holders are entitled to PSU dividends, equivalent to the dividend they would have received if they held their PSUs as common shares.

Performance targets are set by the Management Resource & Compensation Committee of the Company's Board of Directors. The number of PSUs which will ultimately vest will be the original number of PSUs granted plus PSUs equal to the value of accrued notional dividends over the performance period. For dividends, the number of PSUs allotted is determined by dividing the total dollar value of the dividend each PSU holder would have received, by the closing share price on the trading day immediately after the dividend date of record. The redemption value of vested PSUs will be in a range from 0% to 200% based on return on capital employed over a three year performance period.

	Years ended December 31,	
	2018	2017
Outstanding, beginning of period	1,582,285	952,236
Granted	562,049	630,049
Redeemed	(429,002)	-
Outstanding, end of period	1,715,332	1,582,285

In 2018, the Company recorded equity-based compensation expense for these PSUs of $1.3 million (2017: expense of $3.0 million), with a corresponding increase to accounts payable and accrued liabilities and other liabilities.

15. Earnings per share

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

16. 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. Significant expenditures are also required to fund new capital roads allowing access to timber stands for harvesting purposes.

As at December 31, 2018, the Company had $7.0 million drawn in its debt facilities and a nil net debt to capitalization ratio (2017: nil). Net debt is defined as long-term debt, 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 buy back shares, issue new shares, source new debt, or sell assets. The Company has internal controls to ensure changes to the capital structure are properly reviewed and approved.

Beginning in 2013, the Company initiated a quarterly dividend program which is being paid from operating cash flows, and is at the discretion of the Company's Board of Directors.

In the current year, the Company renewed a Normal Course Issuer Bid permitting the purchase and cancellation up to 19,662,439 common shares prior to August 8, 2019, and is at the discretion of the Company's Board of Directors.

Under the Credit Facility agreement, the Company is subject to financial covenants. The Credit Facility contains a maximum consolidated total debt to total capitalization ratio financial covenant of 50%. Should the ratio exceed 42.5%, an EBITDA interest coverage ratio of not less than 2.0 to 1.0, calculated on the trailing 12 month basis, must be maintained. Total capitalization for this covenant is defined as the sum of consolidated total debt and consolidated net worth; this financial covenant is measured on the last day of each reporting period.

As at December 31, 2018, 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 Option Plan, commitments exist to issue common shares.

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

17. Commitments and contingencies

(a) *Key dates in the softwood lumber duty dispute*

Under the softwood lumber agreement ("SLA") between Canada and the United States ("US"), the Company's exports to the US were assessed an export tax by the Canadian Government. The SLA expired on October 12, 2015, eliminating export tax measures on Canadian softwood lumber shipments to the US.

The twelve-month standstill period of the SLA, which precluded the US lumber industry from petitioning for trade relief against Canadian softwood lumber producers, expired on October 12, 2016.

On November 25, 2016, the US lumber industry petitioned the US Department of Commerce ("DoC") and the US International Trade Commission ("ITC") seeking Countervailing ("CVD") and Anti-dumping duties ("AD") on Canadian softwood lumber shipments to the US.

On January 6, 2017, the ITC concluded that there was "reasonable indication" that softwood lumber products from Canada materially injured US producers, allowing the DoC to proceed with its ongoing CVD and AD investigations on these products.

On April 24, 2017, the DoC announced a preliminary CVD rate of 19.88% for "all other" Canadian lumber producers including Western. The DoC also made a preliminary determination on critical circumstances that resulted in 90-day retroactive application of CVD. On June 26, 2017, the DoC announced an AD rate of 6.87% for "all other" Canadian lumber producers including Western. The DoC also made a preliminary determination on critical circumstances that resulted in 90-day retroactive application of AD.

17. Commitments and contingencies (continued)

(a) Key dates in the softwood lumber duty dispute (continued)

On November 2, 2017, the DoC announced reduced, final CVD and AD rates of 14.25% and 6.58%, respectively, for "all other" Canadian lumber producers including Western. In addition, the DoC concluded that critical circumstances did not exist for CVD but did exist for AD.

On December 7, 2017, the ITC made an affirmative final determination that softwood lumber from Canada materially injured the US lumber industry. The ITC also concluded that critical circumstances did not exist for AD. The final rates communicated by the DoC on November 2, 2017 became effective December 28, 2017.

On January 3, 2018, DoC published amended final determinations, resulting in reduced, final CVD and AD rates of 14.19% and 6.04% respectively for "all other" Canadian lumber producers including Western.

(b) Lumber duties and export tax

Cash deposits for CVD were required for lumber imports to the US effective April 28, 2017 through August 25, 2017, after which they were not applicable pending the ITC's final CVD determination. Cash deposits for CVD resumed on publication of ITC final affirmative CVD determination in the US Federal Register on December 28, 2017.

Cash deposits for AD were required for lumber imports to the US effective June 30, 2017 until December 26, 2017, and resumed on publication of the ITC final affirmative injury determination on December 28, 2017. As at December 31, 2018, Western had $64.2 million of cash on deposit with the US Department of Treasury in respect of these softwood lumber duties (December 31, 2017: $18.0 million).

In 2017, the Company recorded an export tax recovery of $3.5 million arising from the difference between export duties paid at preliminary determination rates and the latest final duty rates, which is presented net of export tax expense in the consolidated statement of comprehensive income. A corresponding increase was recognized in other assets in the consolidated statement of financial position. Incremental export duty recoveries from any future change in CVD and AD rates will be netted against export tax expense and included in other assets. In 2018, the Company recorded a further export tax recovery of $0.3 million due to changes in foreign exchange rates.

(c) 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. Where the Company is not able to determine the outcome of these disputes no amounts have been accrued in these financial statements.

(d) Long-term fibre supply agreements

Accounting policy

The Company recorded the price premium as deferred revenue 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 Company's long term fibre supply agreements with third parties have minimum volume requirements and may, in the case of a failure to produce the minimum volume, require the Company to conduct whole log chipping or sell saw logs, which could reduce log availability for our sawmill, source the deficiency from third parties at additional cost to the Company or pay the party to the fibre supply agreement a penalty calculated based on the provisions contained in the relevant agreement. Should Western take significant market related curtailments in its sawmills, the volume of chips produced is reduced and accordingly there is greater risk that the Company may not meet its contractual obligations, if it is not possible to secure replacement chips on the open market during that period.

The Company satisfied its annual fibre commitments for 2018.

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

17. Commitments and contingencies (continued)

(e) Operating leases

Accounting policy

Leases of property, plant and equipment that transfer to the Company substantially all of the risks and rewards of ownership are classified as finance leases. The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognized in the Company's statement of financial position.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease. Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Supporting information

Future minimum lease payments at December 31, 2018 under operating leases were as follows:

2019	$ 3.7
2020	3.3
2021	2.9
2022	2.2
2023	1.9
Thereafter	5.7
	$ 19.7

(f) Pension funding commitments

The Company is committed to making estimated annual special payments in relation to its salaried pension plans of $3.1 million for 2019 and approximately $2.0 million per year on average for 2020 to 2032, or until such time as a new funding valuation may lead to a change in the amount of payments required.

(g) Tax correspondence

In May 2018, the Company received correspondence from the Canada Revenue Agency ("CRA") regarding certain restructuring transactions, occurring in 2004 and 2007 to 2011, and the general anti-avoidance rule. Management believes the CRA's position is without merit. Management is prepared to defend its position if a notice of reassessment is issued, and as such, the Company has not recognized any income tax provision at December 31, 2018 relating to this matter.

18. Employee benefits

Accounting policy

(a) Termination benefits

Termination benefits are expensed at the earlier of when the Company can no longer withdraw the offer of those benefits and when the Company recognizes costs for a restructuring. If benefits are not expected to be settled wholly within twelve months of the reporting date they are discounted.

(b) Short-term employee benefits

Short-term employee benefit obligations, including bonus plans, are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

18. Employee benefits (continued)

(c) Employee future benefits

The Company has various defined benefit and defined contribution plans that provide pension or other retirement benefits to most of its salaried employees and certain hourly employees not covered by forest industry union plans. The Company also provides other post-employment benefits and pension bridging benefits to eligible retired employees.

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The Company's net obligation in respect of its defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of the plan assets is deducted in arriving at the obligation. The calculation is performed annually by a qualified actuary using the actuarial cost projected unit credit method.

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

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined liability, taking into account any changes in the net defined benefit liability during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in net income.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in net income. The Company recognizes gains and losses on settlement of a defined benefit plan when the settlement occurs. A defined contribution plan is a retirement plan under which the Company pays fixed contributions into a separate entity. For Western's defined contribution plan, the Company makes contributions to privately administered investment funds on behalf of the plan members. The Company has no further payment obligations once the contributions have been paid.

The contributions are recognized as employee benefit expense in net income for the period during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

For hourly employees covered by forest industry union defined benefit pension plans, the Company's contributions as required under the collective agreements are charged to net income for the period.

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

18. Employee benefits (continued)

Supporting information

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

	December 31, 2018		December 31, 2017	
	Salaried Pension Plans	Non-pension Plans	Salaried Pension Plans	Non-pension Plans
Plan assets:				
Fair value, beginning of year	$ 112.5	$ -	$ 109.2	$ -
Company contributions	3.7	0.2	3.9	0.3
Benefits and administrative expenses paid	(8.6)	(0.2)	(8.9)	(0.3)
Actual return on assets	(1.6)	-	8.3	-
Fair value, end of year	$ 106.0	$ -	$ 112.5	$ -
Accrued benefit obligation:				
Balance, beginning of year	$ 129.1	$ 4.8	$ 126.5	$ 5.8
Current service costs and administrative expenses	0.3	-	0.3	-
Benefits and administrative expenses paid	(8.6)	(0.2)	(8.9)	(0.3)
Interest cost	4.1	0.1	4.5	0.2
Actuarial loss (gain)	(2.9)	(1.7)	6.7	(0.9)
Balance, end of year	$ 122.0	$ 3.0	$ 129.1	$ 4.8
Deficit recognized in Statement of Financial Position (Note 11)	$ (16.0)	$ (3.0)	$ (16.6)	$ (4.8)
Cumulative actuarial gains (losses), beginning of year	$ (34.7)	$ 1.3	$ (32.3)	$ 0.4
Actuarial gains (losses) recognized directly in OCI	(2.4)	1.7	(2.4)	0.9
Cumulative actuarial gains (losses), end of year	$ (37.1)	$ 3.0	$ (34.7)	$ 1.3

	December 31, 2018		December 31, 2017	
	Salaried Pension Plans	Non-pension Plans	Salaried Pension Plans	Non-pension Plans
Experience gains (losses):				
Experience gains (losses) on plan assets:				
Amount	$ (5.4)	n/a	$ 4.3	n/a
Percentage of plan assets	(5.11)%	n/a	3.79%	n/a
Experience gains (losses) on plan liabilities:				
Amount	$ (0.1)	$ 0.6	$ (2.0)	$ -
Percentage of plan assets	(0.05)%	20.45%	(1.53)%	0.00%

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

18. Employee benefits (continued)

The Company has several funded and unfunded defined benefit plans, a defined contribution pension plan and a group RRSP that provide retirement benefits to substantially all salaried employees and certain hourly employees. In addition, the Company provides other unfunded post-employment benefits to certain former salaried and hourly employees.

The funded and unfunded defined benefit pension plans were closed to new entrants effective June 30, 2006. No further benefits accrue under these plans for years of service after December 31, 2010, and no further benefits accrue under these plans for compensation increases effective December 31, 2016. 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, 2018 were $17.0 million (December 31, 2017: $17.4 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 performed at December 31, 2016. The next actuarial valuation for both the funded and unfunded defined benefit plans and other unfunded post-employment benefit plans will be prepared for December 31, 2019. Included in the accrued benefit obligations and plan assets for salaried pension plans, presented above, are accrued benefit obligations of $116.2 million at December 31, 2018 (December 31, 2017: $123.0 million) in respect of plans that are wholly or partially funded.

The following is a breakdown of the defined benefit pension plan assets by nature of investment categories:

	December 31, 2018	December 31, 2017
Equity securities	28%	32%
Debt securities	69%	65%
Other	3%	3%
	100%	100%

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations (expressed as weighted averages) are as follows:

	December 31, 2018	December 31, 2017	December 31, 2018 Increase (Decrease) of Accrued Benefit Obligation with Change in Assumption 1% Increase	1% Decrease
Discount rate, beginning of year for:				
Pension plans	3.33%	3.67%	n/a	n/a
Non-pension plans	3.25%	3.55%	n/a	n/a
Discount rate, end of year for:				
Pension plans	3.60%	3.33%	12,059,900	(14,500,800)
Non-pension plans	3.45%	3.25%	231,300	(265,800)
Rate of compensation increase for all plans	0.01%	0.01%	(47,900)	44,400
Health care and medical cost trend rate	5.61% in 2019 grading to 3.86% in 2029	4.88% in 2018 grading to 3.65% in 2026	(149,400)	154,200
Future mortality	n/a	n/a	314,700	(317,900)

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

18. Employee benefits (continued)

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

	December 31, 2018		December 31, 2017	
	Salaried Pension Plans	Non-pension Plans	Salaried Pension Plans	Non-pension Plans
Defined benefit plans:				
Current service costs and administrative expenses	$ 0.3	$ -	$ 0.3	$ -
Net interest costs	0.5	0.1	0.5	0.2
Cost of defined benefit plans	0.8	0.1	0.8	0.2
Total cost of employee post-retirement benefits	$ 0.8	$ 0.1	$ 0.8	$ 0.2

The Company is committed to make funding contributions to its defined benefit plans of $3.1 million during 2019.

The Company's unionized employees are members of industry-wide pension plans to which the Company contributes a predetermined amount per hour worked by an employee. The Company's liability is limited to its contributions. The pension expense for these plans is equal to the Company's contributions. For 2018, such contributions amounted to $9.4 million (2017: $9.7 million).

19. Financial instruments – fair values and risk management

Accounting policy

The Company has adopted IFRS 9, *Financial Instruments*, with a date of initial application of January 1, 2018. IFRS 9 sets out requirements for recognizing and measuring financial assets, financial liabilities, and certain contracts to buy or sell non-financial items. IFRS 9 replaces IAS 39, *Financial Instruments: Recognition and Measurement*. It largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. IFRS 9 eliminates IAS 39 categories for financial assets of held to maturity, loans and receivables, and available for sale. The adoption of IFRS 9 has not had a significant effect on the Company's accounting policies related to financial liabilities. The impact of IFRS 9 on the classification of financial assets is set out below.

(a) Financial assets

The Company classifies its financial assets in the following categories: amortized cost, fair value through other comprehensive income ("FVOCI") – debt investment; FVOCI – equity investment; or fair value through profit and loss ("FVTPL"). This classification of a financial asset is based on the business model in which a financial asset is managed and its contractual cash flow characteristics

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

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

A financial asset is measured at amortized cost if it meets both of the following conditions, and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Company does not currently have any debt or equity investments classified as measured at FVOCI.

19. Financial instruments – fair values and risk management (continued)

(a) Financial assets (continued)

All financial assets not measured at amortized cost or FVOCI are measured at FVTPL. This includes all derivative financial assets. On initial recognition, the Company may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortized cost or at FVOCI as at FVTPL if doing so reduces an accounting mismatch that would otherwise arise.

A financial asset not measured at FVTPL is initially measured at fair value plus transaction costs that are directly attributable to its acquisition. A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Upon initial recognition, directly attributable transaction costs are recognized in net income as incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in net income. Financial assets at fair value through profit or loss are comprised of certain investments and forward exchange contracts.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially recognized at transaction price plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Loans and receivables comprise cash and cash equivalents, trade and other receivables. Cash and cash equivalents comprises cash balances and short-term investments with original maturities of 90 days or less.

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

IFRS 9 also replaces the incurred loss model in IAS 39 with an expected credit loss (“ECL”) model. The new impairment model applies to financial assets measured at amortized costs, contract assets and debt investments at FVOCI. Under IFRS 9, credit losses are recognized earlier than under IAS 39. The financial assets held at amortized cost consist of cash and cash equivalents and trade and other receivables.

Under IFRS 9, loss allowances are measured on either of 12 month ECLs where the ECLs result from all possible default events within the 12 months after the reporting date; or lifetime ECLs, where the ECLs result from all possible default events over the expected life of a financial instrument.

The Company measures loss allowances at an amount equal to twelve months ECLs for cash and cash equivalent balances where credit risk has not increased significantly since initial recognition. The Company has elected to measure loss allowances for trade receivables and any future contract assets at an amount equal to lifetime ECLs

ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all expected cash shortfalls and are discounted at the effective interest rate of the financial asset. At each reporting date the Company assesses whether financial assets carried at amortized costs are credit-impaired. A financial asset is considered credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Loss allowances for financial assets measured at amortized cost are deducted from the gross carrying amount of the assets. Impairment losses related to trade and other receivables, including contract assets, are presented separately in the statement of comprehensive income.

No adjustment to credit losses was required on adoption of IFRS 9.

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

19. Financial instruments – fair values and risk management (continued)

(b) Financial liabilities

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

(c) 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. These financial instruments are measured at FVTPL. The Company's policy is not to use derivative financial instruments for trading or speculative purposes. These instruments have not been designated as hedges for accounting purposes, and they are carried on the statement of financial position at fair value with changes in value being recognized as gains or losses within sales in net income for the period.

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

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

(d) Accounting classifications and fair values

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair valuation hierarchy. It does not include fair value information for financial assets or liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value. There has been no movement between fair value levels since December 31, 2017.

	December 31, 2018			December 31, 2017		
	Mandatory at at FVTPL	Amortized Cost	Total	Mandatory at FVTPL	Amortized Cost	Total
Financial assets						
Market-based investments	$ 4.9	$ -	$ 4.9	$ 5.1	$ -	$ 5.1
Foreign currency forward contracts	-	-	-	0.7	-	0.7
Cash and cash equivalents	-	8.4	8.4	-	35.3	35.3
Trade and other receivables	-	91.3	91.3	-	85.5	85.5
Total financial assets	$ 4.9	$ 99.7	$ 104.6	$ 5.8	$ 120.8	$ 126.6
	Mandatory at FVTPL	Other Financial Liabilities	Total	Mandatory at FVTPL	Other Financial Liabilities	Total
Financial liabilities						
Foreign currency forward contracts	$ 2.2	$ -	$ 2.2	$ -	$ -	$ -
Accounts payable and accrued liabilities	-	130.5	130.5	-	98.9	98.9
Long term debt (Note 9)	-	7.0	7.0	-	-	-
Total financial liabilities	$ 2.2	$ 137.5	$ 139.7	$ -	$ 98.9	$ 98.9

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

19. Financial instruments – fair values and risk management (continued)

(e) Financial risk management

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

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

(i) Credit risk

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

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

Sales transactions are made through the extension of credit to customers and are recorded at the point in time the sale is recognized. Accordingly, fluctuations in collectability may affect the carrying value of the underlying accounts receivable. Management balances the credit risk through rigorously and continually reviewing customer credit profiles. The Company has established policies and controls to review the creditworthiness of new customers, including review of credit ratings. The Company's general practice is to insure substantially all North American lumber receivables for 90% of value with the Export Development Corporation or Coface Canada, while substantially all sales outside of North America are sold on either a cash basis or with secured instruments, which reduces the Company's exposure to bad debts.

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, 2018, the Company had an allowance for doubtful customer accounts of nil (December 31, 2017: nil).

The aging of trade and other receivables at the reporting date that were not impaired was as follows:

	December 31, 2018		December 31, 2017	
	Gross value	Impairment	Gross value	Impairment
Not past due	$ 85.0	$ -	$ 73.6	$ -
Past due, 0 - 30 days	6.1	-	12.5	-
Past due, 31 - 120 days	0.2	-	0.1	-
	$ 91.3	$ -	$ 86.2	$ -

The Company held cash and cash equivalents of $8.4 million at December 31, 2018 (December 31, 2017: $35.3 million), which represents its maximum credit exposure on these assets. The cash and cash equivalents are held at highly rated financial institutions and as such, the Company does not believe that these are exposed to significant credit risk.

(ii) Interest rate risk

The Company is exposed to interest rate risk through its current financial assets and financial obligations bearing variable interest rates. Based on the Company's debt structure at December 31, 2018, a change of 1% in interest rates would result in an immaterial change to the annual net income (2017: immaterial change). The Company does not currently use derivative instruments to reduce its exposure to interest rate risk.

19. Financial instruments – fair values and risk management (continued)

(e) Financial risk management (continued)

(iii) Currency risk

Certain of the Company's sales transactions are denominated in foreign currencies, principally, the USD and Japanese Yen ("JPY"), and accordingly the Company is exposed to currency risk associated with changes in foreign exchange rates. To assist in managing this exchange risk, the Company sells forward contracts with a maximum term for each transaction of up to one year. The Company does not consider the credit risk associated with the counterparty risk to be significant.

During 2018, the Company entered into forward contracts to sell USD and JPY in order to mitigate a portion of the foreign currency risk. At December 31, 2018, the Company had outstanding obligations to sell an aggregate USD$62.3 million at an average exchange rate of CAD$1.33 per USD with maturities through March 28, 2019, and to sell JPY 155.0 million at a rate of JPY 80.40 per CAD with maturities through January 9, 2019.

All foreign currency gains and losses on forward contracts to December 31, 2018 have been recognized in sales in the consolidated statement of comprehensive income and the fair value of these instruments at December 31, 2018 was a net liability of $2.2 million which is included in accounts payable and other liabilities on the consolidated statement of financial position (December 31, 2017: net asset of $0.7 million). A net loss of $5.1 million (2017: net gain of $0.7 million) was recognized in sales in the consolidated statement of comprehensive income on the change in fair values of the foreign exchange contracts.

An increase (decrease) of 1% in the value of the CAD as compared to the JPY would result in an immaterial gain (loss) in relation to the JPY Yen/CAD foreign exchange contracts held at December 31, 2018. An increase (decrease) of 1% in the value of the CAD as compared to the USD would result in a gain (loss) of approximately $0.7 million in relation to the USD foreign exchange contracts held at December 31, 2018.

Certain receivable balances at December 31, 2018 are denominated in foreign currencies, principally, the USD. Accordingly, fluctuations in foreign exchange rates may affect the carrying value of the underlying accounts receivable. As of December 31, 2018, the Company's accounts receivable denominated in USD totaled USD$38.0 million. An increase (decrease) in the value of the Canadian dollar by USD$0.01 would result in a decrease (increase) in USD denominated accounts receivable at year end of approximately $0.4 million. In addition, as at December 31, 2018, the Company had a total of USD$1.9 million in USD denominated cash and cash equivalents. An increase (decrease) in the value of the Canadian dollar by USD$0.01 would result in an immaterial change to USD denominated cash and cash equivalents at year end.

(iv) Commodity price risk

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

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

19. Financial instruments – fair values and risk management (continued)

(v) Liquidity risk

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

As at December 31, 2018, the Company had $242.0 million (December 31, 2017: $234.0 million) available under its credit facility. The following are the contractual maturities of financial liabilities, including estimated interest payments:

	Carrying amount	Contractual cash flows	6 months or less	6 - 12 months	2 - 3 years	4 - 5 years	More than 5 years
Accounts payable and accrued liabilities	$ 132.7	$ 132.7	$ 132.7	$ -	$ -	$ -	$ -
Long term debt	7.0	11.5	0.6	0.6	10.3	-	-
	$ 139.7	$ 144.2	$ 133.3	$ 0.6	$ 10.3	$ -	$ -

20. Finance costs

Accounting policy

Finance costs comprise interest expense on long-term debt and the revolving credit facility, amortization of deferred financing costs, unwinding of the discount on the reforestation obligation, changes in the fair value of investments recognized immediately through net income and net interest on the net defined benefit plan obligation. All finance costs are recognized in net income during the period using the effective interest method with the exception of the net interest on the net defined benefit obligation, which is recognized as described in Note 18.

Supporting information

	Years ended December 31, 2018	2017
Long-term debt	$ 0.8	$ 0.6
Net interest - defined benefit plan obligation	0.9	1.1
Revolving credit facility	0.3	0.5
Amortization of deferred financing costs	0.5	0.3
Unwinding of discount on provisions	0.3	0.3
Other	(0.1)	(0.3)
	$ 2.7	$ 2.5

21. Operating restructuring items

Included in operating restructuring expenses in 2018 were $4.8 million (2017: $14.4 million) which included $2.2 million of non-operating costs incurred subsequent to the indefinite curtailment of the Company's Somass sawmill, $1.4 million in severance and related expenses attributable to ongoing business optimization initiatives, and $0.6 million incurred to retrain employees impacted by the closure of the Englewood train. Expenses incurred in 2017 included $11.7 million in ongoing non-operating costs and voluntary severance to certain salaried and all hourly employees of the Somass sawmill, and $2.4 million of severance related to the closure of the Englewood train.

22. Segmented information

Accounting policy

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

A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments. Western's log and lumber products are sold worldwide. Substantially all of Western's property, plant and equipment, biological assets and timber licences are located in British Columbia, Canada. The Company manages its business as a single operating segment. The Company purchases and harvests logs which are then manufactured into lumber products at the Company's sawmills, or sold. Supporting information is included in Note 23.

23. Revenue

The Company has adopted IFRS 15, *Revenue from Contracts with Customers*, with a date of initial application of January 1, 2018. The adoption of IFRS 15 does not have a material impact on these consolidated financial statements, other than in the form of additional disclosures included herein. The Company has updated its accounting policy for revenue recognition to reflect the qualitative changes of the new standard, as set out below.

In the comparative period, revenue was measured at the fair value of consideration received or receivable, net of rebates and discounts. Revenue from sale of goods was recognized when the significant risks and rewards of ownership had been transferred to the customer, recovery of the consideration was probable, the associated costs and possible return of goods could be estimated reliably, there was no continuing management involvement with the goods and the amount of revenue could be measured reliably.

Accounting policy

Revenue from the sale of goods is measured based on the consideration specified in a contract with a customer, net of rebates and discounts, and after eliminating intercompany sales. Revenue is recognized when control over a product transfers from the Company to the customer. The timing of transfer of control varies depending on the individual term of the contract of sale.

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

The following is a description of principal activities from which the Company generates its revenue.

Lumber

Revenue is recognized when control over lumber is transferred to the customer. The timing of transfer of control varies depending on the individual terms of the contract of sale, but is typically at the time lumber is loaded onto the mode of transportation. The amount of revenue recognized is adjusted for discounts related to early payment at the point in time control is transferred, based on historical experience.

Logs

Revenue is recognized when control over logs is transferred to the customer. The timing of transfer of control varies depending on the individual terms of the contract of sale, but is typically at the time logs are loaded onto the vessel or delivered to the transfer point, and payment is secured. No discounts are offered for logs.

By-products

Revenue is recognized when control over by-products is transferred to the customer, the timing of this transfer of control varies depending on the individual terms of the contract of sale, but is typically at the time by-products leave the Company's facilities or are scaled at the pick-up location. Invoices are generated and revenue is recognized at that point in time. No discounts are offered for by-products.

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

23. Revenue (continued)

Supporting information

(a) *Disaggregation of revenue*

In the following table, revenue is disaggregated by primary geographical market, based on the known origin of the customer, and by major products.

	Year Ended December 31, 2018	Year Ended December 31, 2017
Primary geographical markets		
Canada	$ 449.1	$ 372.4
United States	290.8	286.4
China	190.9	221.0
Japan	152.0	153.0
Other	100.0	79.7
Europe	13.9	30.9
	$ 1,196.7	$ 1,143.4
Major Products		
Lumber	$ 952.9	$ 858.2
Logs	160.0	214.8
By-products	83.8	70.4
	$ 1,196.7	$ 1,143.4

(b) Contract balances

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

	December 31, 2018	December 31, 2017
Receivables	$ 91.3	$ 86.2
Contract liabilities	54.4	56.4

The contract liabilities relate to the consideration received from a customer for a long-term fibre supply contract and are recognized as deferred revenue, for which revenue is recognized straight-line over the term of the contract. The contract liabilities decreased $2.0 million during the year ended December 31, 2018 as the amount was recognized as revenue.

Contract costs

The Company will capitalize costs to obtain contracts and amortize fees when related revenues are recognized, where the amortization period is greater than one year.

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

24. Related parties

Accounting policy

Key management personnel are the Company's directors and executive officers as disclosed in its 2018 and 2017 Annual Reports as applicable.

Supporting information

Compensation of key management personnel

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

	Years ended December 31, 2018	Years ended December 31, 2017
Salaries, directors' fees and short-term benefits	$ 7.2	$ 6.6
Post-employment benefits	0.3	0.3
Share-based compensation, including mark-to-market adjustment	2.7	4.4
	$ 10.2	$ 11.3

At December 31, 2018, $9.1 million of key management compensation costs were included in accounts payable and accrued liabilities and other liabilities (December 31, 2017: $9.9 million).

25. Expense categorization

Expenses by function:

	Years ended December 31, 2018	Years ended December 31, 2017
Administration	$ 21.1	$ 21.9
Distribution expenses	144.5	129.9
Cost of goods sold	927.7	874.6
	$ 1,093.3	$ 1,026.4

Costs by nature:

	Years ended December 31, 2018	Years ended December 31, 2017
Compensation costs	$ 213.4	$ 223.0
Amortization in cost of goods sold	39.3	35.4
Amortization in selling and administration	0.9	0.9
	$ 253.6	$ 259.3

Compensation costs are included in cost of goods sold and selling and administration.

26. Subsequent event

On February 1, 2019, the Company completed an acquisition of the assets of Columbia Vista Corporation and certain related entities located in Vancouver, Washington for consideration of US$30.5 million, subject to a working capital adjustment.

Western Forest Products Inc.

DEFINING A HIGHER STANDARD™

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