



## Materials

---

March 23<sup>rd</sup>, 2015

# Western Forest Products

*Joseph Kaprielian, Senior Analyst*  
*Alexandre Veronneau, Junior Analyst*

# Western Forest Products

## Desautels Capital Management

---

### Disclaimer

---

The print and digital material ("the material") for this presentation was prepared by the analyst team of Desautels Capital Management ("DCM"). The qualitative and statistical information ("the information") contained in the material is based upon various sources and research believed to be reliable and DCM makes every effort to ensure that the information is accurate and up to date, but DCM accepts no responsibility and gives no guarantee, representation or warranty regarding the accuracy or completeness of the information quoted in the material. For reasons of succinctness and presentation, the information provided in the material may be in the form of summaries and generalizations, and may omit detail that could be significant in a particular context or to a particular person. Any reliance placed on such information by you shall be at your sole risk.

Opinions expressed herein are current opinions as of the date appearing in this material only and are subject to change without notice. In the event any of the assumptions used herein do not prove to be true, results are likely to vary substantially. All investments entail risks. There is no guarantee that investment strategies will achieve the desired results under all market conditions and each investor should evaluate its ability to invest for a long term especially during periods of a market downturn. No representation is being made that any account, product, or strategy will or is likely to achieve profits, losses, or results similar to those discussed, if any. This information is provided with the understanding that with respect to the material provided herein, that you will make your own independent decision with respect to any course of action in connection herewith and as to whether such course of action is appropriate or proper based on your own judgment, and that you are capable of understanding and assessing the merits of a course of action. DCM shall not have any liability for any damages of any kind whatsoever relating to this material. You should consult your advisors with respect to these areas. By accepting this material, you acknowledge, understand and accept the foregoing.

No part of this document may be reproduced in any manner, in whole or in part, without the prior written permission of DCM, other than current DCM employees. Should you wish to obtain details regarding the various sources or research carried out by DCM in the compilation of this marketing presentation please email [mcgillhim@gmail.com](mailto:mcgillhim@gmail.com).

# Stock Pitch

## Table of Contents

---



### Section I: Materials Current Situation

- Current Sector Allocation

### Section II: Forestry Industry

- Macro Outlook

### Section III: Western Forest Products

- Company Overview
- Annotated Price Charts
- Management & Business Model

### Section IV: Investment Thesis

- Industry Tailwind
- Flexible Revenue Structure
- Attractive Valuation

### Section V: Valuation

- Comparable Companies Analysis
- Base, Bear & Bull Case Assumptions
- DCF
- Football Field



### Section VI: Recommendation

- Risks and Catalysts
- Forward Looking Sector Allocation

### Section VII: Appendix

## Section I

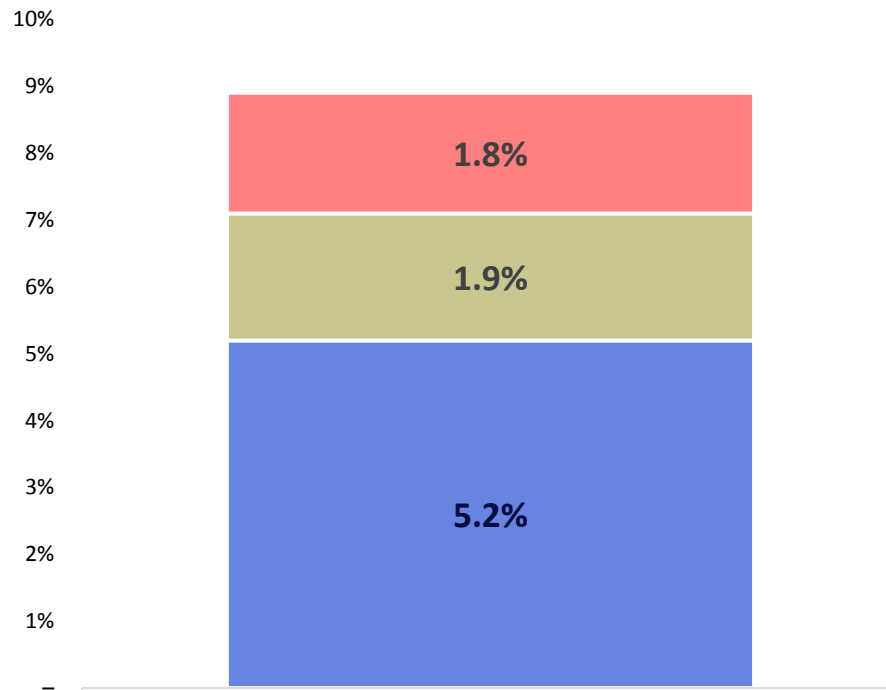
---

# Current Sector Allocation

# Allocation

## Materials Portfolio

### Current Sector Allocation



**lundin mining**



Looking to get into the forestry subsector in order to further diversify

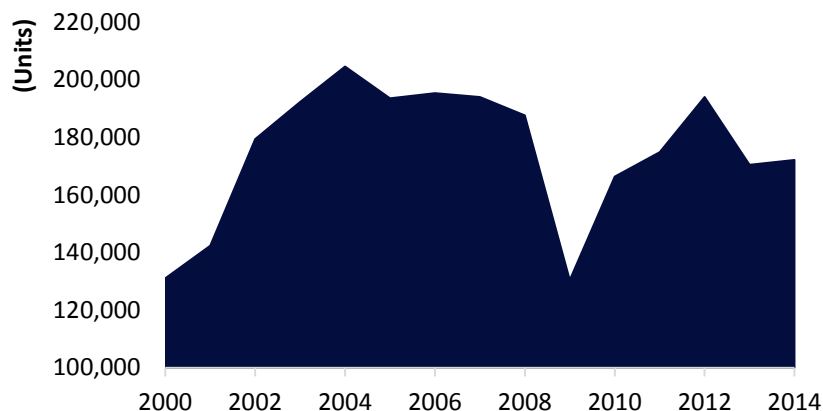
## Section II

---

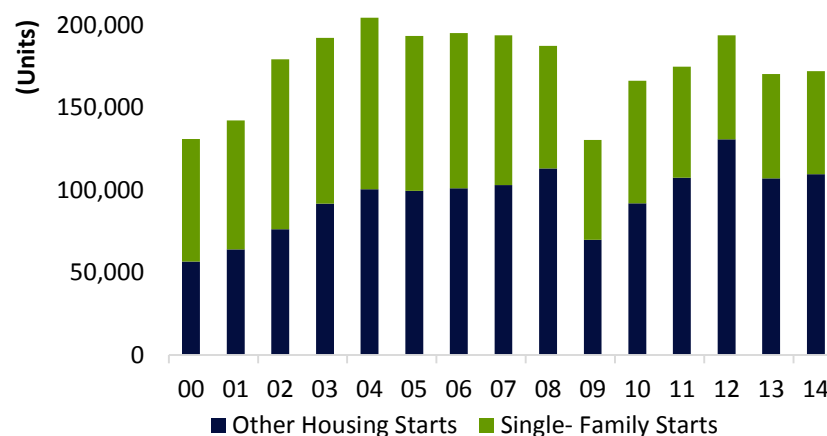
# Forestry Industry

# Canada - Housing Market Outlook

## Canada Total Yearly Housing Starts



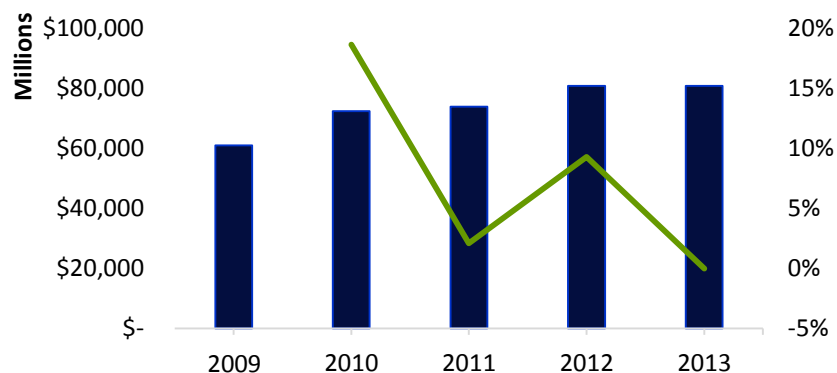
## Canada Housing Starts by Dwelling Type



## Recent Trends

- The Canadian market show signs of recovery between 2009 and 2012 when looking at the country's historical total yearly housing starts
- The Canadian housing market shows signs of recovery earlier than the U.S. market and has suffered a step back in 2013 and 2014.
- The total value of building permits issued has seen a significant y.o.y. growth of 19% in 2010 but has stalled ever since

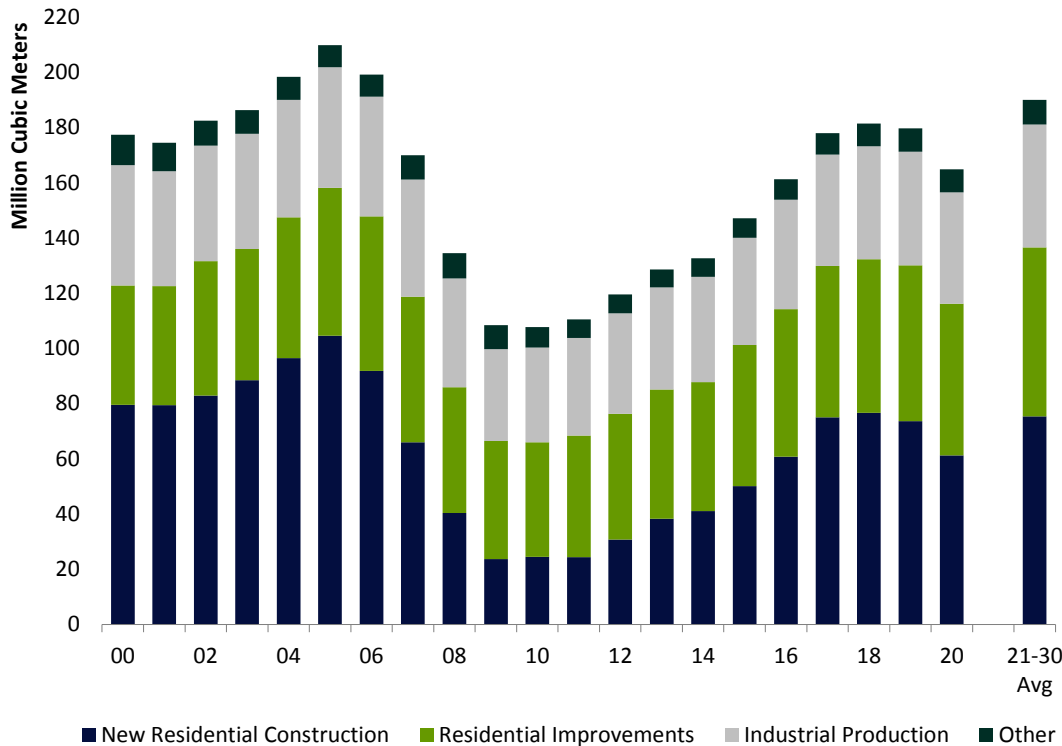
## Total Value of Building Permits Issued



Source: Statistics Canada.

# United States - Housing Market Outlook

## Wood Products Consumption by End-Use Sector



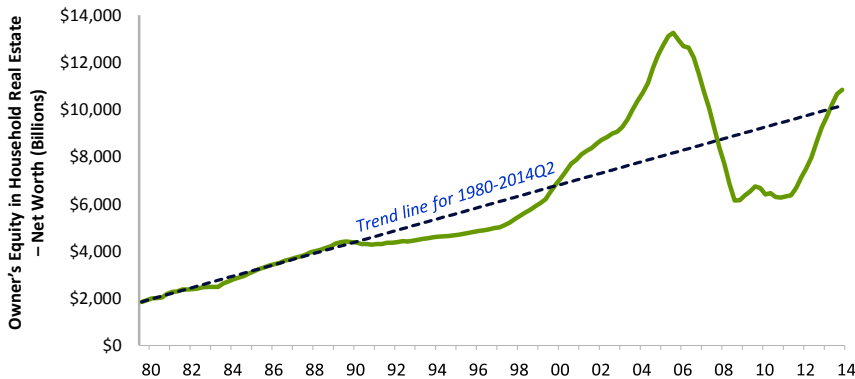
- Despite the downturn of 2007-2010, the housing sector remains the most important end-use market for the U.S. wood products
- U.S. wood products consumption is mainly composed of:
  - Softwood lumber
  - OSB and softwood plywood
  - Particle board
  - MDF
- Repair, remodeling and industrial uses have fared comparatively well over the last several years, and their shares will decline as new home construction reasserts its primacy going forward

The new residential construction share of total consumption peaked at 50% in 2005 and troughed at 22% in 2009-11 and is now expected to grow to 42% by 2017

Source: (FEA) Forest Economic Advisor Presentation

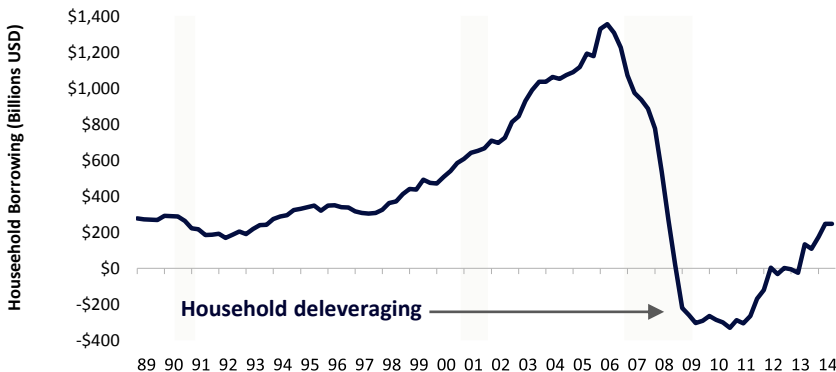
# United States - Housing Market Outlook

## U.S. Home Equity Now Exceeds Its Long Term Trend



- Households home equity has rallied by 70% in 2012
- This increase in households equity was fuelled by a 24% increase in home prices form 2012 to the end of 2014<sup>(1)</sup>
- The increase in equity prices have also contributed to stronger household balance sheet
- Higher household equity level is likely to drive improvement and remodeling activities

## U.S. Households Have Now Stopped Deleveraging



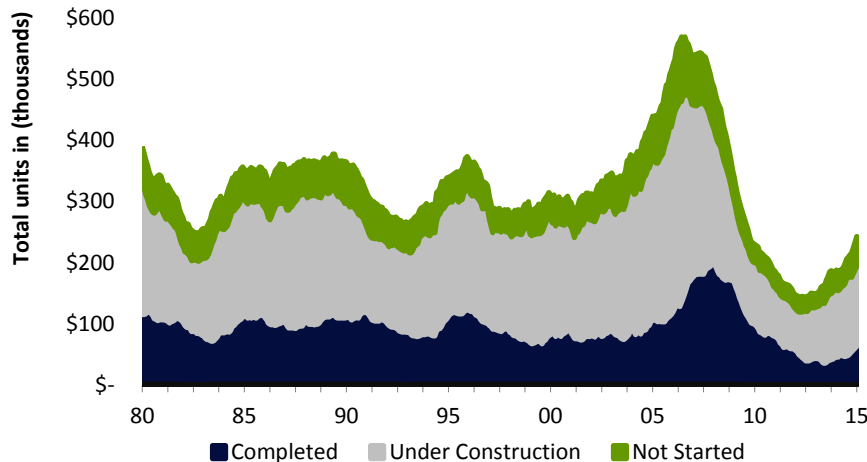
- The household deleveraging cycle seen throughout the course of the housing crash and the recovery period is over
- Household deleveraging has been a key restraint on aggregate demand for new house construction, for improvement, remodeling and for existing residential properties
- The increasing trend in the willingness of households to lever up will most likely drive the demand for new and existing housing properties

Source: Federal Reserve Flow of funds Data, 2014

(1) As measured by the Case-Shiller top 20 metros index

# United States - Housing Market Outlook

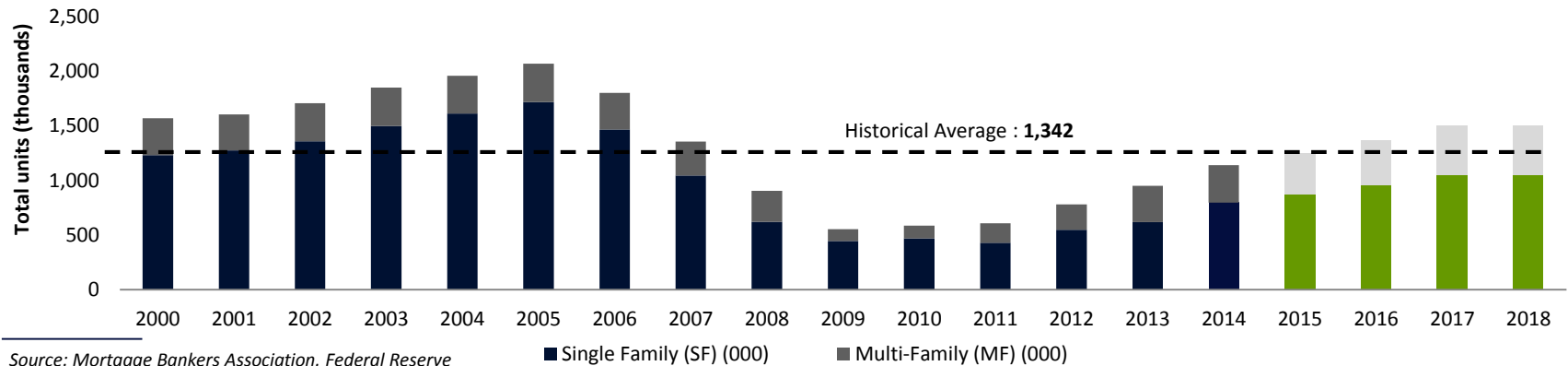
## New Single Family Home Inventories



## Single Family Starts Lagging Builder Confidence



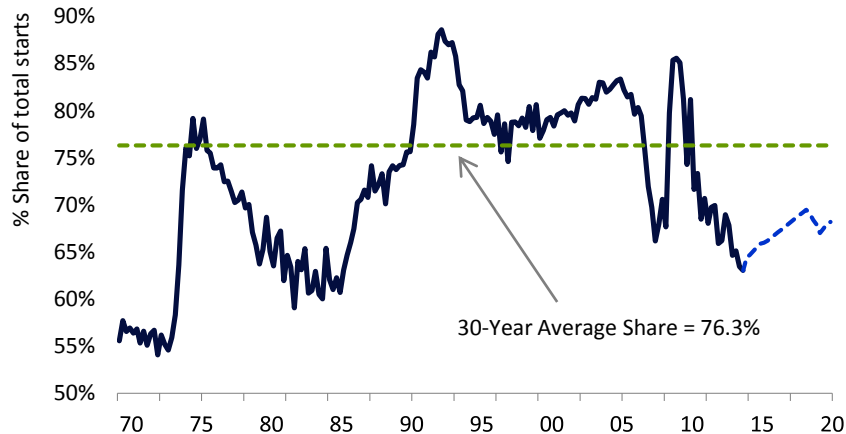
## Historical Housing Starts and DCM Forecasts



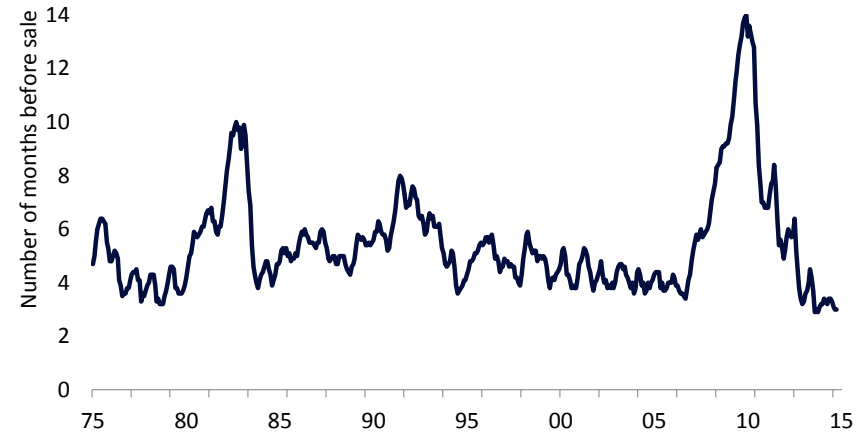
Source: Mortgage Bankers Association, Federal Reserve

# United States - Housing Market Outlook

## Share of Single-Family of Housing Starts



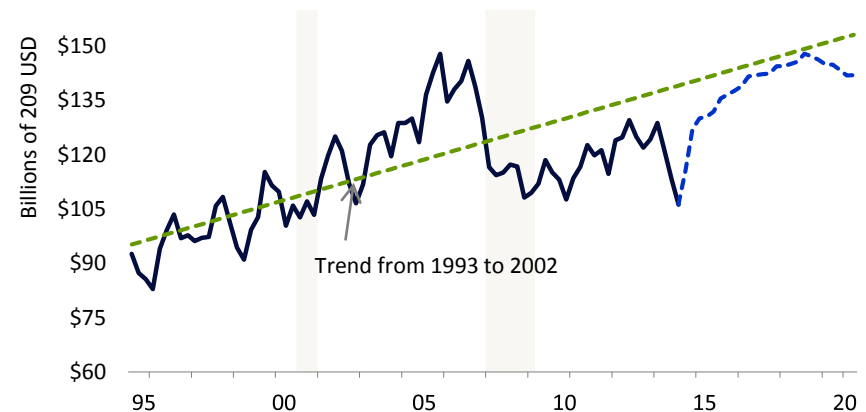
## Completed New Homes Are Selling Quickly



## Key Takeaway

- Single-family Share of total housing starts expected to pick up between 2015 & 2017
- Single-family home in the U.S. uses about three times as much lumber and structural panels as a multifamily unit. (Highly correlated to wood product demand and prices)
- Residential improvements and remodeling are expected to reach their long-term trend gradually by 2018; R&R spending forecasted to grow by 4.5% between 2014-18 vs. 1.2% between 2009-13

## Home Improvement Expenditure



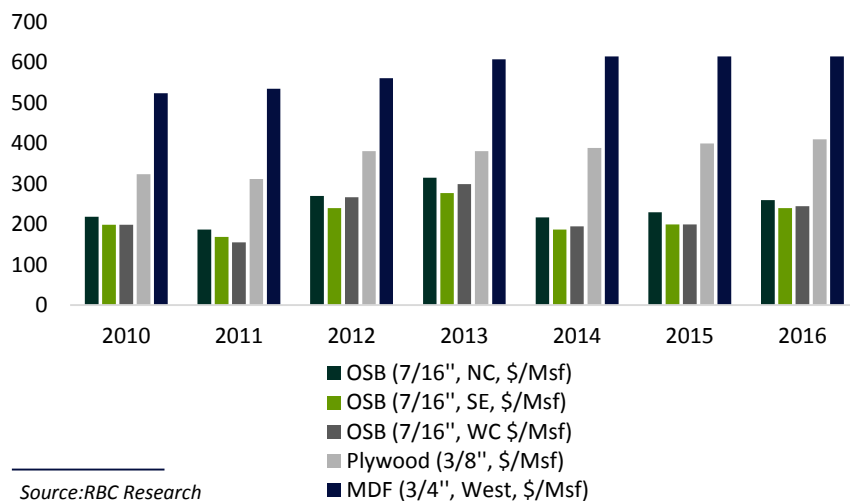
Source: U.S. Census Bureau  
(FEA) Forest Economic Advisor Presentation

# Forestry Products Price Forecasts

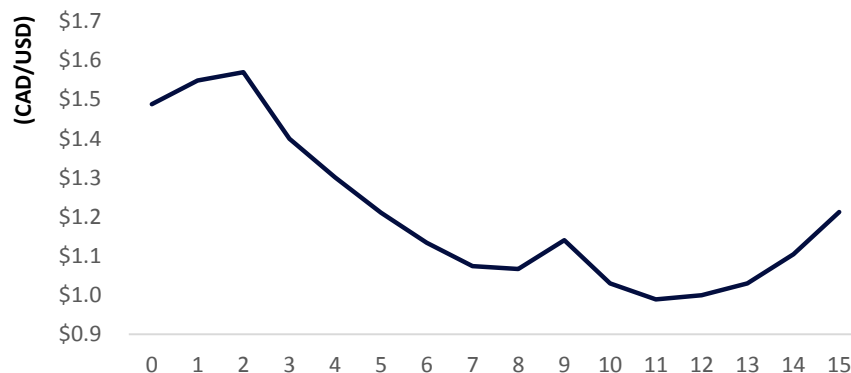
## Short-Term Trends

- The U.S. housing market recovery is expected to continue driving prices going forward
- The increasing utilization of wood products such as structural wood, softwood lumber and engineered wood products like OSB panel in China is boosting the demand for wood type products and drives the forecasted increase in prices
- The continued devaluation of the CAD will also increase the demand for Canadian forest products

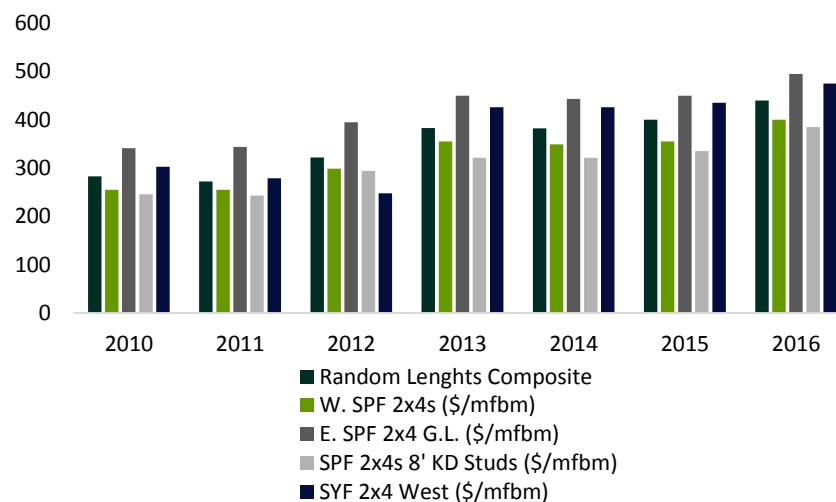
## Panels Price Forecasts



## Favorable Exchange Rates



## Lumber Price Forecasts





## Section III

---

# Western Forest Products

# Western Forest Products

## Company Overview



### Company Description

Western Forest Products is a Canadian lumber producer engaged in timber harvesting and manufacturing of wood products

- Operating in British Columbia, serving global markets
  - Largest crown timber tenure holder in Coastal B.C.
  - Largest cedar lumber manufacturer in North America
- The company owns 7 sawmills representing 1.1 billion board feet of production capacity and 2 remanufacturing plants on the Vancouver island

### Financial Summary<sup>(1)</sup>

<b>Share Price</b>	<b>\$1.90</b>
Dividend per share	0.08
Dividend yield	4.21%
52 week high	\$2.80
52 week low	\$1.84
Share outstanding (mm)	394.9
<b>Market cap (mm)</b>	<b>\$750</b>
Less: Cash (mm)	\$2
Total Debt (mm)	\$80
Add: Operating Leases	\$8
Add: Employee future benefits obligations	\$29
<b>Enterprise Value (mm)</b>	<b>\$869</b>

### Sawmills and Manufacture Locations



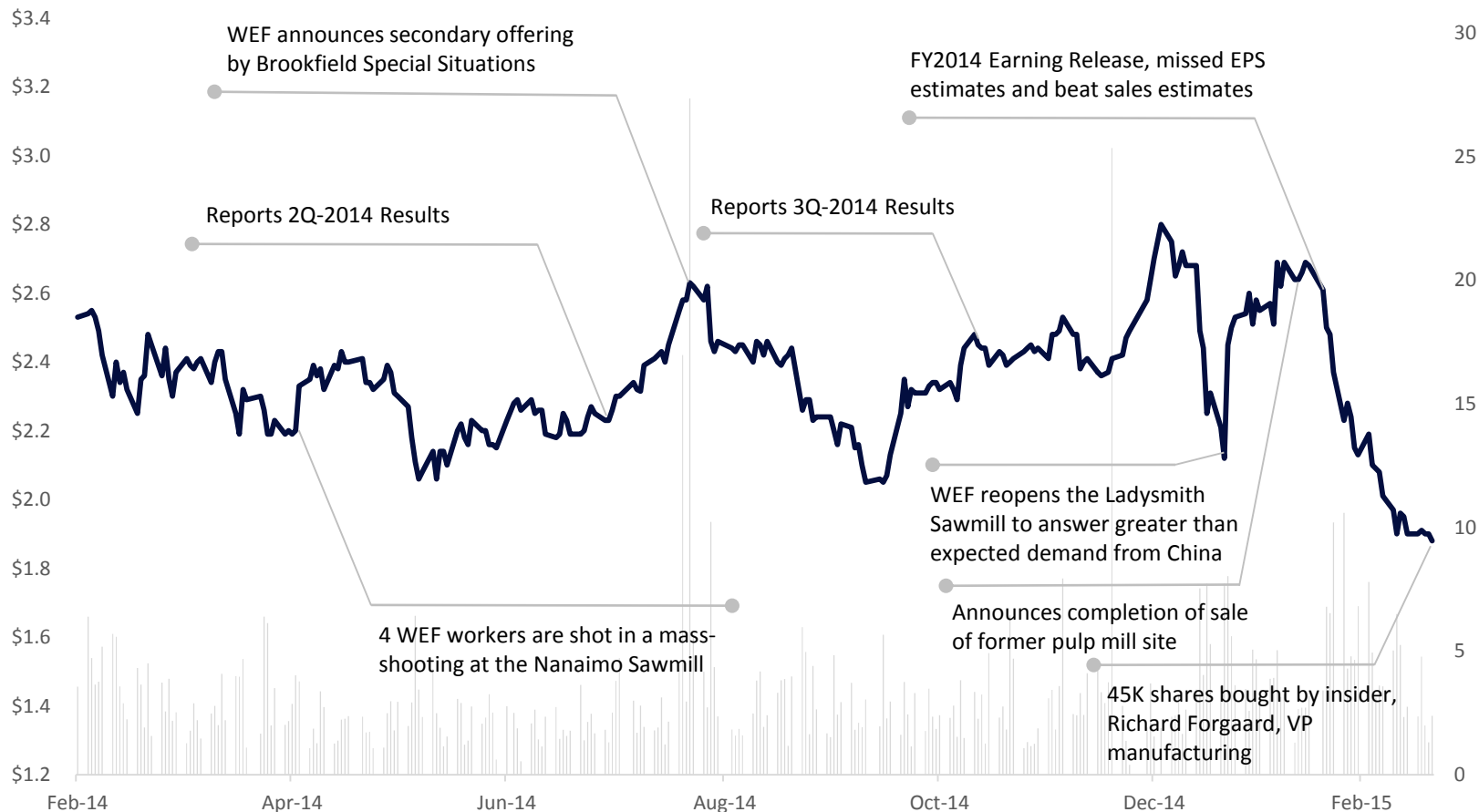
(1) As at 19/03/2015, all figures in CAD

### Stock Price Performance



# Western Forest Products

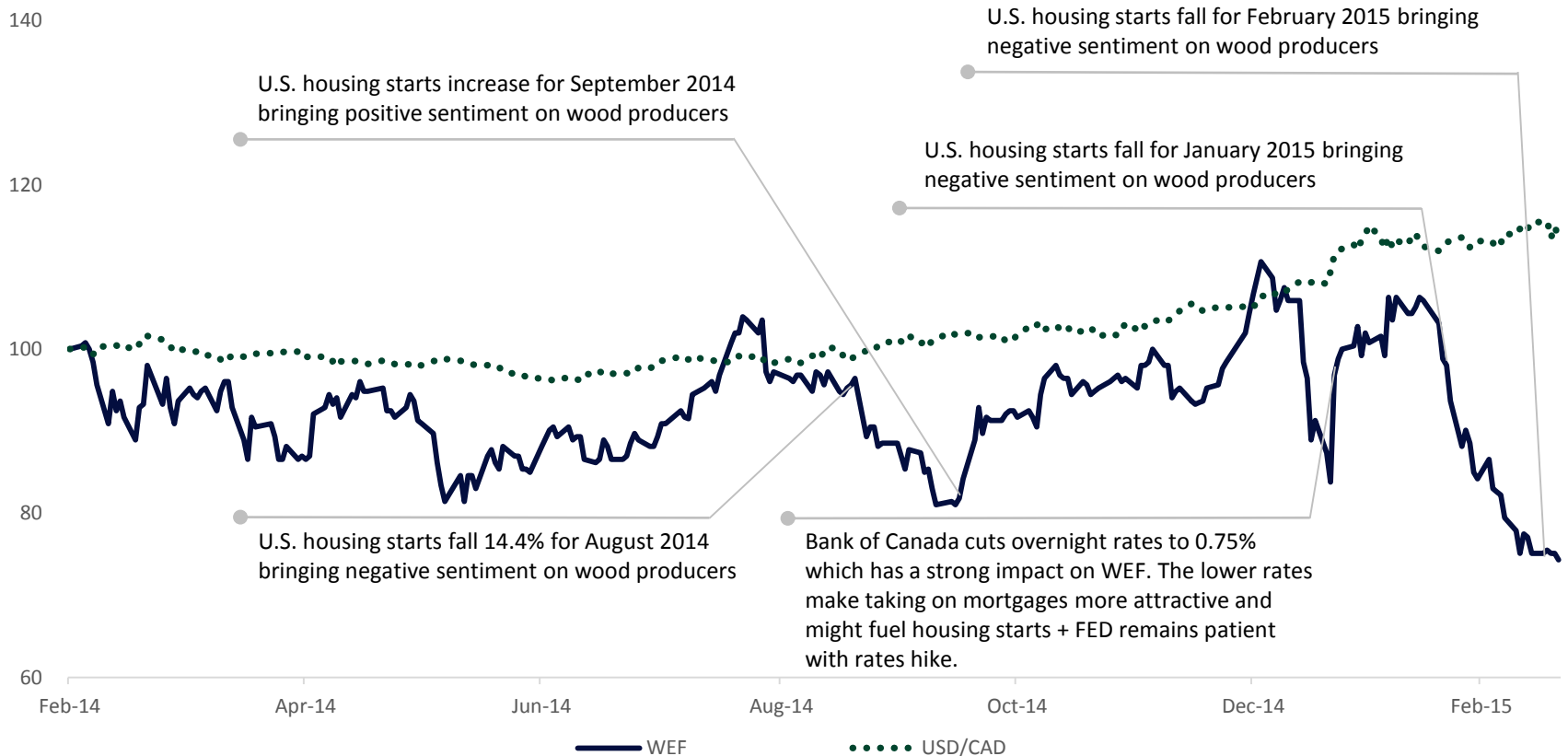
## Annotated Price Graph – Firm Specific Events



Source: Bloomberg, March 21, 2015

# Western Forest Products

## Annotated Price Graph - Macroeconomic Variables



Western Forest Products is greatly affected by the U.S. & Canadian housing market and by the monthly housing starts data. Also, the FED & BOC interest rate announcements have quite an impact on WEF because they drive the attractiveness of mortgages.

Source: Bloomberg, March 21, 2015

# Western Forest Products

## Annotated Price Graph - Comparison with Peers



WEF appears to be recently over penalized by the market when compared with peers. Despite a very positive second half of 2014 for forestry stocks, the weak housing starts data the beginning of 2015 creates an attractive buying opportunity.

Source: Bloomberg, March 21, 2015

# Western Forest Products

## THE BOYS - Strong Management Team



**Don Demens**

President & CEO

-----

25 years of experience in the industry (GM IFP), including time spent in Japan. He gradually moved up the ranks within WFP serving in several leadership roles since 2009.

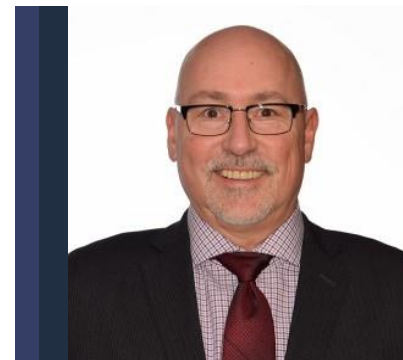


**Stephen Williams**

VP, CFO & Corporate Secretary

-----

20 years experience in the forestry industry with extensive executive level experience in financings, organizational change and merger and acquisitions



**Rick Forgaard**

VP Manufacturing

-----

30 years of experience in multi-site manufacturing operations and capital programs focused on delivering top quartile results

Ever since Mr. Demens appointment as CEO, he has been leveraging his extensive experience in Japan's forestry industry to increase the company's sales and to capture a greater Japanese market share

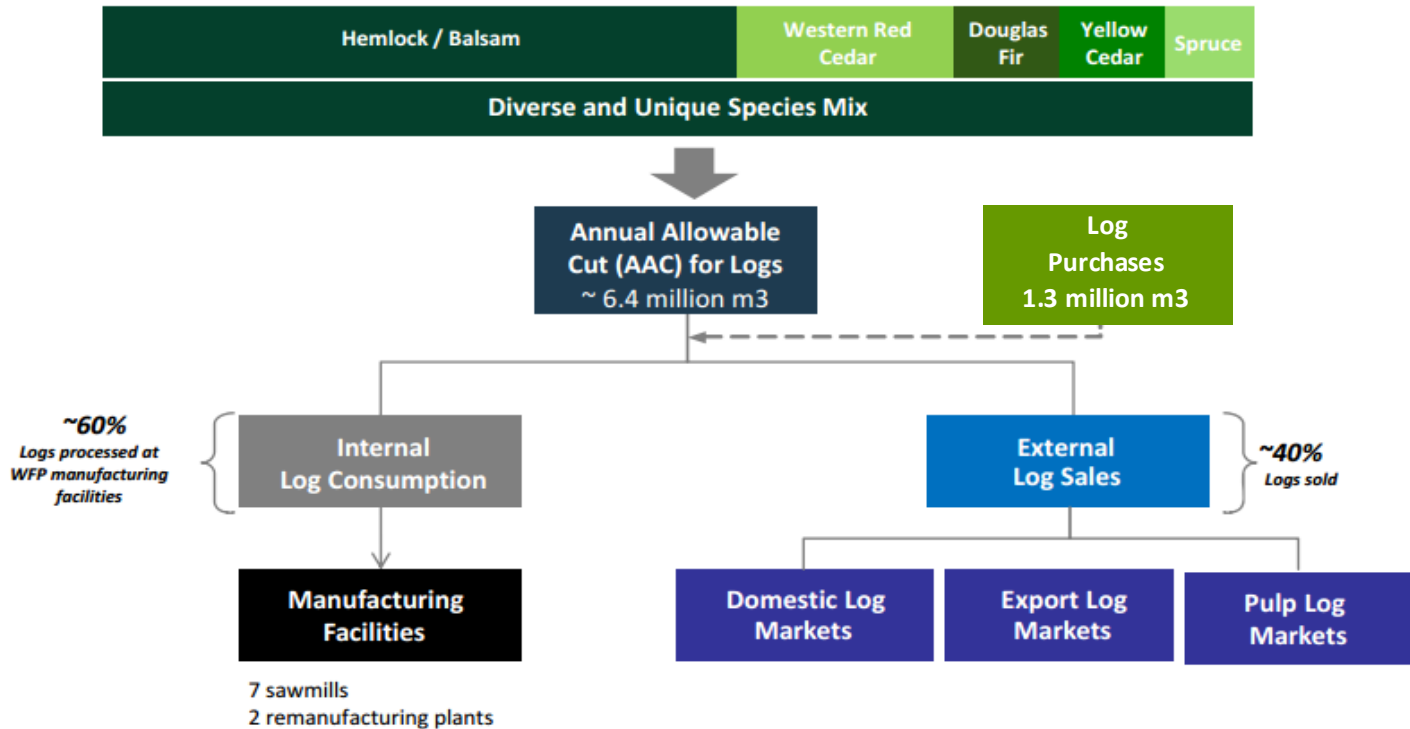
*Source: Company Official Website.*

# Western Forest Products

## Business Model



### WEF's operational structure



Flexibility to direct and source timber resources to the highest margin opportunity

Source: Corporate Investor Presentation

## Section IV

---

# Investment Thesis

# Western Forest Products

## Investment Thesis



### 1. Industry Tailwind & Favorable Macro Trends

- The Canadian forestry industry is set to benefit from the full recovery of the United States housing market which is expected to be fully realized within the next couple of years
- Current macroeconomic dynamics yields opportunities for Western Forest Products to capture a greater market share in the North American & Asian markets
- The strength of the USD relative to the CAD increases the company's profitability

### 2. Flexible Revenue Structure & Strong Fundamentals

- Diversified & flexible revenue structure both geographically and by product type will allow WEF to benefit from changing macroeconomic environment and lowers the company business risk
- The company benefits from a strong balance sheet with significant hard assets, high liquidity and industry low leverage
- Margin focus strategy & recent strategic capital investments will strengthen the company's operating margin going forward

### 3. Attractive Valuation

- The company is trading at a discount to peers on a P/E & EV/EBITDA basis for 2014-2016 despite having higher margins, low leverage and lower risk profile
- The recent drop in stock price to C\$1.90 over the past month provides an attractive entry point
- DCF Gordon growth, DCF terminal EBITDA multiple and Comparable 2015 EBITDA Multiple valuation methods yield a base case weighted average target price of C\$2.51 which represents an upside of 32%

# Western Forest Products



## 1. Industry Tailwind & Favorable Macroeconomic Trends

### WEF Set to be a Prime Beneficiary of 3 Main Underlying Market Dynamics

#### Mountain Pine Beetle Infestation

- The mountain pine beetle infestation is affecting the assets of some of WEF's biggest Canadian and U.S. competitors leaving WEF with a greater North American & Asian market share to capture

#### Strengthening U.S. Housing Market

- Western plans to focus on growing its share of WRC and niche markets in the U.S., which continue show signs of increasing demand fueled by a strong repair and remodeling sector

#### Reduction in Asian Exports by US Wood Producers

- The American housing market recovery will drive most North American producers to target the U.S. to benefit from lower export costs. This gradual shift will reduce current export volume to Asia allowing WEF's to capitalize on a greater Asian market share

### Strategic Positioning

#### Vancouver Island

- WEF's assets are located with close proximity to one another in order to allow minimal transportation costs
- Both manufacturing plants and most of the company's sawmills are located near the shore which facilitates exports
- The Company is strategically positioned to supply the U.S., Canadian & Asian markets

### Currency Futures Market Indicating Continued Strength of the USD

	Historical			Forecasted				
	<u>2012A</u>	<u>2013A</u>	<u>2014A</u>	<u>2015F</u>	<u>2016F</u>	<u>2017F</u>	<u>2018F</u>	<u>2019F</u>
FX Rate - US\$ / C\$	\$1.00	\$0.97	\$0.91	\$0.78	\$0.76	\$0.80	\$0.80	\$0.81

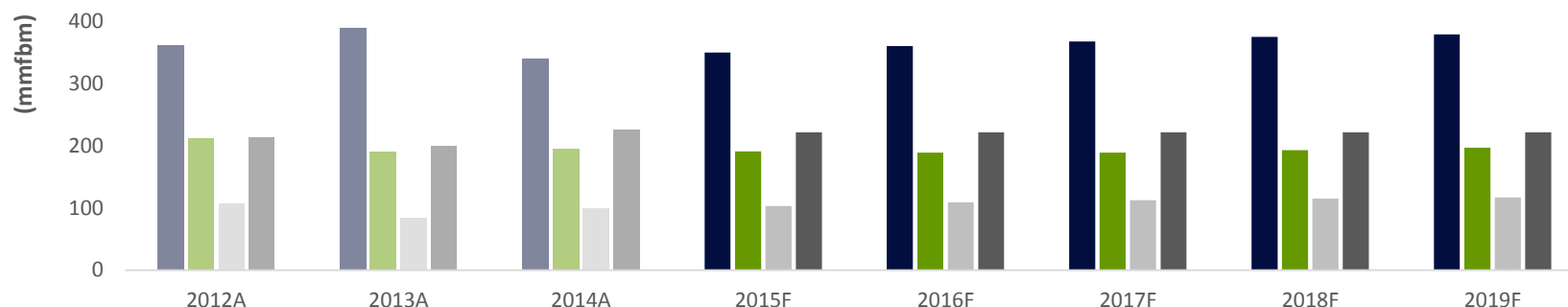
# Western Forest Products

## 1. Production & Shipments Outlook



### Total Shipments by Products

		Historical			Forecasted				
		2012A	2013A	2014A	2015F	2016F	2017F	2018F	2019F
Commodity Shipments	(mmfbm)	362	390	340	350	361	368	375	379
Japan Shipments	(mmfbm)	212	190	195	191	189	189	193	197
Niche Shipments	(mmfbm)	107	84	100	103	109	112	115	117
Western Red Cedar Shipments	(mmfbm)	213	200	226	221	221	221	221	221
Logs Shipments	(000 m3)	3,430	2,769	2,377	2,377	2,389	2,341	2,294	2,248



#### 2014 Highlights:

- 2% increase in lumber sales volume in 2014, which rose to 909 million board feet
- 9% increase in Western Red Cedar (WRC) volume and 7% increase in Niche Products sales volume, both driven by continuing demand from a strong North American repair and renovation market
- 5% reduction in log harvesting activity due to unfavorable weather conditions

Source: Royal Bank of Canada and TD Bank Research Reports

Source: DCM forecasts

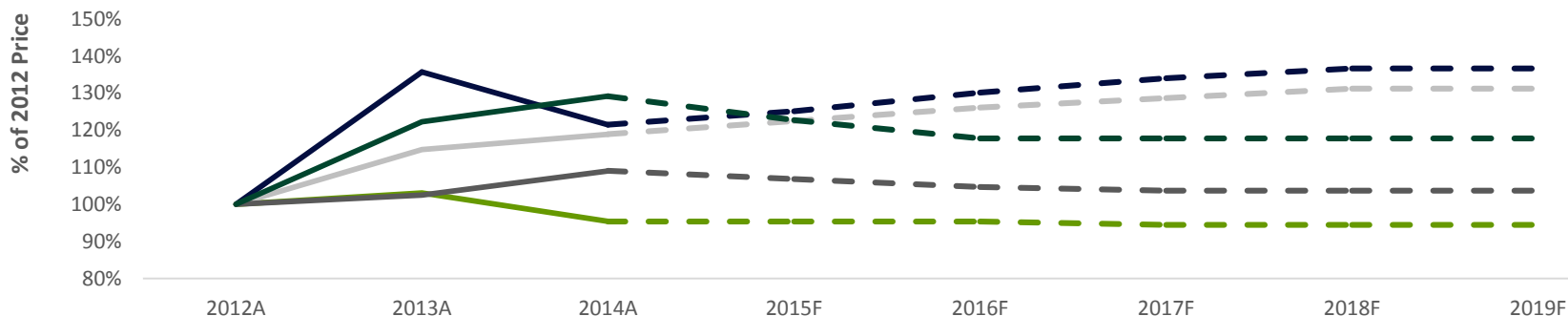
# Western Forest Products

## 1. Pricing Outlook



### Historical & Forecasted Commodity Prices

		Historical			Forecasted				
		2012A	2013A	2014A	2015F	2016F	2017F	2018F	2019F
Commodity Price	\$US/Unit	345	468	419	432	449	462	472	472
Japan Specialty Price	\$US/Unit	973	1,003	928	928	928	919	919	919
Niche Products Price	\$US/Unit	757	869	900	927	955	974	993	993
Western Red Cedar Price	\$US/Unit	998	1,023	1,088	1,066	1,045	1,034	1,034	1,034
Log Price	\$US/Unit	72	88	93	88	85	85	85	85



#### 2014 Highlights & 2015-16 Outlook:

- The decrease in commodity pricing in the second half of 2014 was a result of slower than anticipated U.S. housing market and weak China Lumber market. The U.S. housing market recovery is expected to realize in 2015-16 while the China lumber market is expected to stabilize.
- Continued strength in the U.S. repair & renovation market, gradual improvement in U.S. new home construction, and the benefit of a weaker CAD should contribute to marginally improve lumber pricing in North America
- Strong American underlying demand for Western Red Cedar and Niche Products should support and increase pricing

Source: Royal Bank of Canada and TD Bank Research Reports mixed with DCM forecasts

# Western Forest Products

## 2. Flexible Revenue Structure & Product Diversification



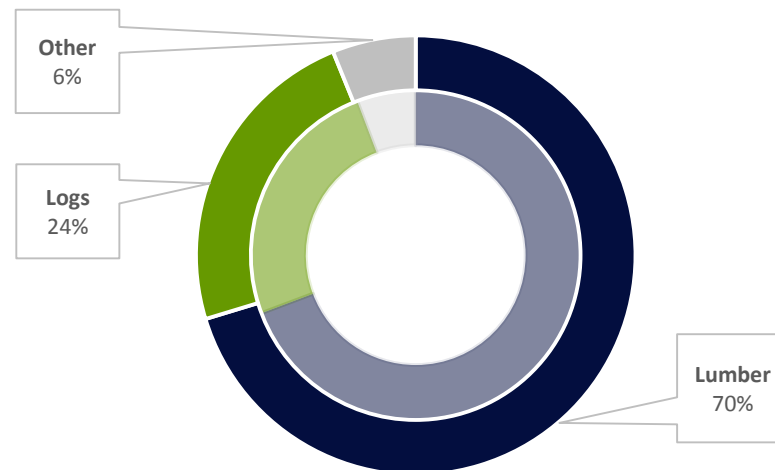
### Diversified Products to Serve Multiple Markets

Lumber Segment	Description	Primary Target	% Value	% Volume
Western Red Cedar	Consumer-Orientated Products	U.S.	35%	24%
	Naturally Durable	Canada		
	Ideal for external use			
Japan Specialty	Products for traditional post and beam construction	Japan	26%	12%
	Requires unique and rigorous quality standards			
Niche	Specialty products and market Focused of appearance grades	U.S.	13%	20%
		Canada		
		Asia		
Commodity	Traditional dimension lumber and developing grades Currently focused on China	Europe	26%	44%
		Australia		
		China		
		U.S.		

#### 74% of WEF's lumber revenue is generated from non-commodity products

- Specialty lumber sells at a significant premium to commodity lumber
- Specialty products provide much more stable margins when compared to commodity grades
- Product / market diversity and global exposure provide additional opportunities to seek best margins
- Cedar, niche and commodity grades will most likely benefit from U.S. housing recovery

### 2014-13 Revenue Segmentation By Products



#### Top line analysis

- WEF derives 70% of its revenue from the sale of lumber products, 51% of the company total revenue comes from higher margin specialty lumber and 19% from commodity lumber products
- 48% of the company's revenue are in USD, 44% are in CAD and 8% are in Japanese Yen.
- Higher margin products and well diversified product line allow WEF's management to pursue the higher margin opportunities and to adjust the company revenue structure to reflect changes in underlying demand

Source: Corporate Investor Presentation

# Western Forest Products

## 2. Flexible Revenue Structure & Product Diversification



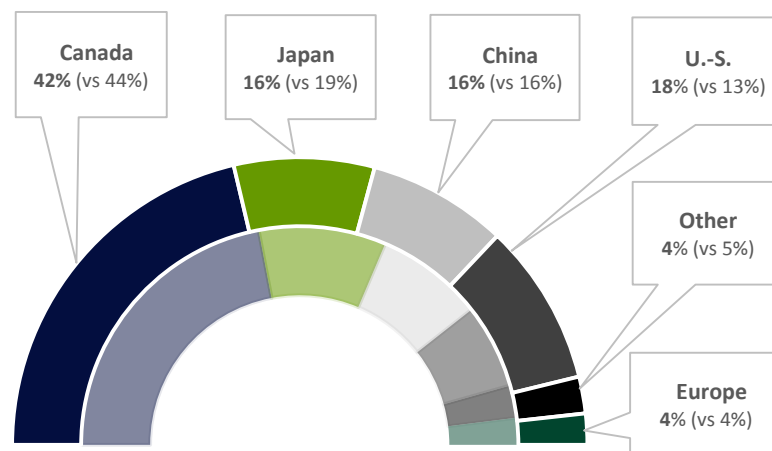
### Directing Volume to High Margins Opportunity

Log End Market	Description	Primary Target Geographies	% Value	% Volume
WEF Sawmills	All five species of WEF's sawlogs consumed by internal manufacturing operations	Canada		
	Internal log supply supplemented by open market purchases to maximize margin			
Domestic Market	Includes sawlogs, peelers and shingle logs sold through contractual commitments and open market transactions	Canada	60%	58%
Export Market	Represents log sorts produced in excess of internal mill requirements Typically command premium prices due to strong demand	China Korea Japan U.S.	19%	19%
Pulplogs Market	Volumes committed under long-term fibre supply agreements Commitments met through internal log supply, contracts and open market pulplogs purchases	Canada	17%	13%
			4%	10%

#### The company benefits from a flexible log end market

- 60% of the company's harvested timber value is used as inputs for its manufacturing facilities
- WEF also sells about 40% of its purchased or harvested timber to the external market depending on the attractiveness of market prices
- The company's flexible structure allows it to pursue the highest margins opportunity under different circumstances

### 2014-13 Revenue Segmentation Per Country



#### Geographical revenue segmentation key take away

- WEF's flexible geographical revenue segmentation allows the company to adjust sales to respond to variations in demand from different countries
- As expected, management was able to gradually begin to shift sales from Japan to the U.S. to reflect weaker demand from Japan in the end of 2014 and stronger demand from the U.S. repair and remodeling sector. This can be seen in the top right pie chart.
- We expect this shift to continue going into 2015

Source: 2014 Financial Statements

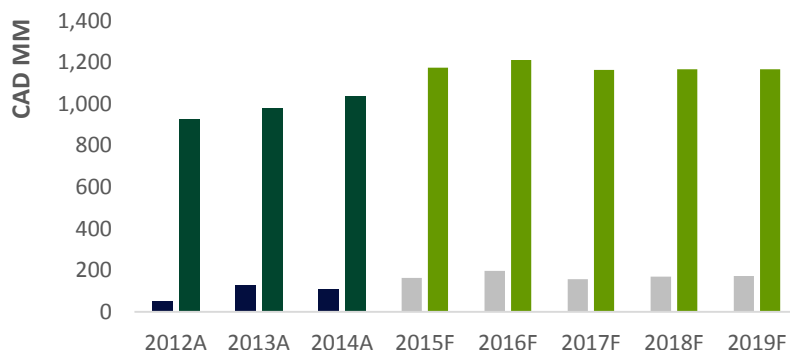
Source: Bloomberg as at 12/31/2014, all figures in CAD

# Western Forest Products

## 2. Revenue Breakdown & Analysis



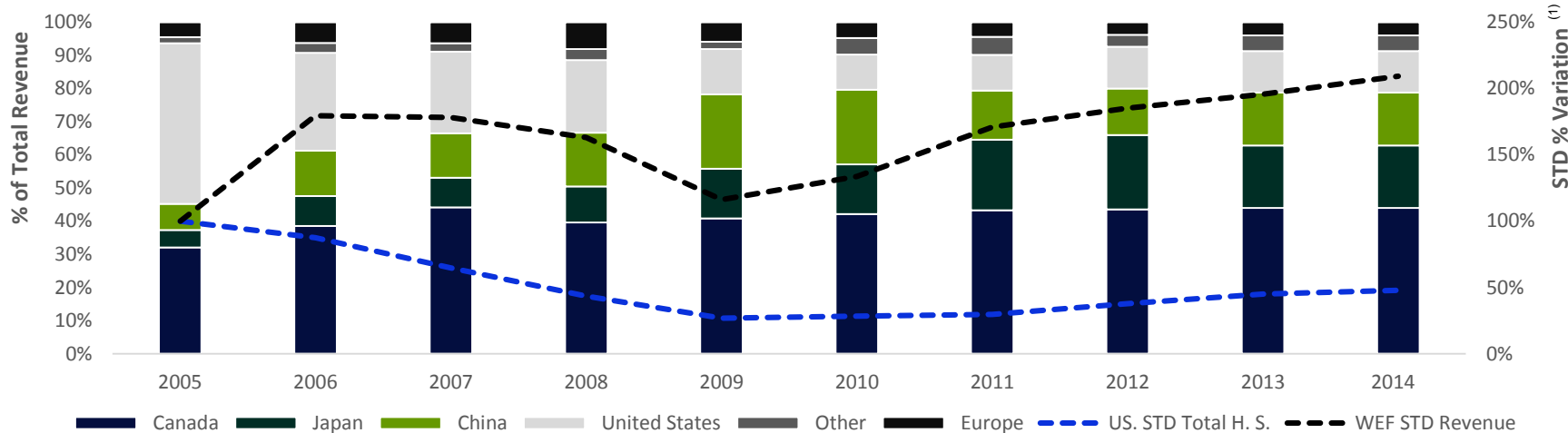
### Total Revenue & Adjusted EBITDA



### Highlights

- Proven ability to adjust the revenue segmentation both geographically and by product to capitalize on improving industry fundamentals all around the globe
- The forecasted increase in commodity price and demand will drive WEF's top line going forward
- We foresee a reduction in U.S. exports to China & Japan due to the increasing value of the USD and the willingness from U.S. producers to increase sales to the U.S., leaving a greater Asian demand for WEF's products

### Geographical Revenue Segmentation (2005-14)



Source: Bloomberg as of 12/31/2014.

## 2. Strong Fundamentals & Strategic Capex Program

### Strong balance Sheet

#### Valuable Assets

- Focus on margin improvements at sawmills
- Investment in machinery at manufacturing plants
- Strategically located properties with great proximity to maximize cost efficiency. Seven properties located near the shore to facilitate maritime exports and reduce costs.

#### Low Debt Level

- Low long term debt of C\$73M with C\$21.8M expected to be repaid after sale of Squamish pulp mill site in early 2015
- Capitalized operating leases of C\$9M mainly for machinery and equipment

### Increasing Liquidity and Credit Worthiness

#### Extended Revolving Term Loan Facility to 2019

- Decreased effective interest rate and extended the term to maturity through to June 2019 by amending its revolving term loan facility.
- The company liquidity position as December 31, 2014 has improved to C\$134.4M compared C\$125.9M. The increase in the liquidity has mainly come from cash generated by operations.

### Strategic Capex Program Expected to Positively Impact FY2015 Results

Location	Description	Status	Completion Date	Value
Cowichan Bay Sawmill	Auto Log Rotation Project	Completed	H2 - 2014	\$2.5M
Duke Point Sawmill	2nd Phase of Overall Modernization Project	Under Way	H1 - 2015	\$6.7M
Niche	Log in-Feed Modernization Project Phase 1	Completed	H2 - 2014	\$4.0M
	Log in-Feed Modernization Project Phase 2	Under Way	H1 - 2015	\$11.0M
Duke Point Sawmill	Planer Facility Update	Approved	H1 - 2015	\$5.1M

MD&A : *"The current multi-year (2012–2016) \$125-million discretionary capex program is intended to yield annual EBITDA benefits of \$32 million. We expect that these margin benefits will start accruing from 2016."*

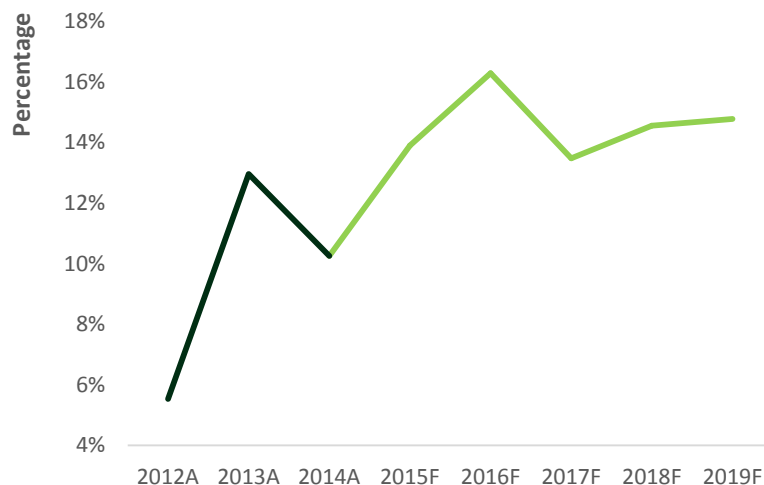
Source: 2014 MD&A

# Western Forest Products

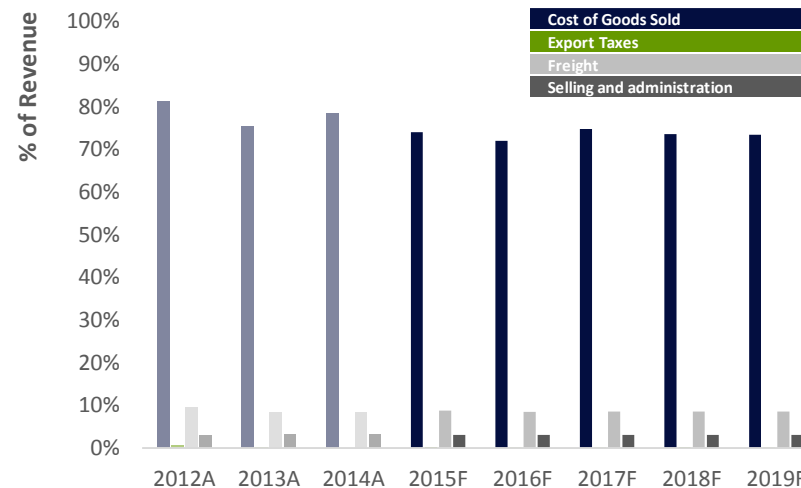
## 2. Cost Outlook Factoring Improved Operating Margins



### Historical & forecasted EBITDA Margin



### Variable Costs



#### 2014 Highlights:

- To offset lower internal log supply from harvesting activities, the company increased its saw logs purchase by 27% in 2014 which resulted in higher production costs and lower margin
- The increase in logs purchase in 2014 was a result of unfavorable weather condition which prevented from harvesting at full capacity
- Log costs increased in 2014 was also due to 80,000 cubic metre increase in the use of heli-logging, increase in stumpage costs and the signature of a new 5 year labor contract which lead to an unexpected increase in wages.

Despite the increase in operating costs in 2014, the company's current focus on strategic capital investments and increasing operating margins will most likely offset the recent negative factors and drive margins going forward

Source: 2014 Annual Report & DCM forecasts

## Section V

---

# Valuation

### 3. Valuation

#### Comparable Companies Analysis



(in CAD\$ millions)													
Company	Share Price CAD	Market Cap CAD	Enterprise Value CAD	EV/EBITDA			P / E			P/B	Dividend Yield	Debt/Equity	Operating Margin
				2014A	2015E	2016E	2014A	2015E	2016E			Q3-14	2014A
Lumber and Logs Producers													
Interfor	\$17.58	\$1,173	\$1,383	11.5x	5.4x	4.2x	19.3x	10.6x	7.7x	2.4x	0.0%	18.8%	2.5%
Canfor	\$25.31	\$3,586	\$4,318	8.6x	6.1x	5.1x	18.0x	11.0x	8.2x	3.3x	0.0%	8.3%	9.8%
Conifex Timber	\$6.99	\$146	\$266	13.2x	6.6x	4.2x	31.8x	9.7x	4.5x	0.9x	0.0%	70.1%	2.6%
Average				11.1x	6.0x	4.5x	23.0x	10.4x	6.8x	2.2x	0.0%	32.4%	5.0%
Panels and Other Wood Products Producers													
West Fraser Timber	\$62.16	\$5,290	\$6,006	10.4x	6.8x	6.1x	18.8x	11.7x	9.4x	9.0x	0.5%	9.3%	10.5%
Boise Cascades	\$49.37	\$1,955	\$2,434	11.1x	8.7x	7.6x	22.0x	16.9x	14.0x	2.1x	0.0%	18.1%	4.1%
Norbord	\$25.22	\$1,359	\$1,834	18.5x	9.6x	4.6x	72.1x	84.1x	15.7x	1.7x	9.5%	37.1%	2.5%
Ainsworth Lumber	\$3.31	\$798	\$1,108	13.8x	13.8x	6.9x	n.a.	16.6x	10.7x	1.4x	0.0%	45.6%	-2.0%
Louisiana-Pacific	\$20.80	\$2,816	\$3,275	144.9x	18.9x	8.2x	n.a.	N.A.	20.0x	3.7x	0.0%	31.4%	13.2%
Average				39.7x	11.6x	6.7x	37.6x	32.3x	13.9x	3.6x	2.0%	28.3%	5.6%
Western Forest Products													
Western Forest Products	\$1.90	\$754	\$868	8.6x	5.3x	4.4x	10.6x	5.6x	5.0x	1.5x	1.1%	10.6%	6.8%

WEF looks significantly undervalued on when compared with comps, when looking at the P/E ratio

Western Forest Products is trading within or below average on an EV/EBITDA basis, while keeping a low level of debt

Source: Bloomberg 02/03/2015

### 3. Valuation

#### DCF Output & Operating Assumptions

Bear Case	Base Case	Bull Case
Effect of weak commodity prices & demand and higher operating costs	Forecasted commodity prices & demand and expected operating costs	Effect of stronger commodity prices & demand and lower operating costs
<b>FX Rate US \$/C\$</b>	<b>FX Rate US \$/C\$</b>	<b>FX Rate US \$/C\$</b>
<ul style="list-style-type: none"> <li>▪ Weaker USD and stronger CAD than what is predicted by the futures curve</li> </ul>	<ul style="list-style-type: none"> <li>▪ FX Rate in line with the futures curve estimate</li> </ul>	<ul style="list-style-type: none"> <li>▪ Stronger USD and weaker CAD than what is predicted by the futures curve</li> </ul>
<b>Sales Volume Growth</b>	<b>Sales Volume Growth</b>	<b>Sales Volume Growth</b>
<ul style="list-style-type: none"> <li>▪ Lower shipment volume than forecasted</li> </ul>	<ul style="list-style-type: none"> <li>▪ Sales volume growth in line with forecasts</li> </ul>	<ul style="list-style-type: none"> <li>▪ Higher shipment volume than forecasted</li> </ul>
<b>Sales Price Growth</b>	<b>Sales Price Growth</b>	<b>Sales Price Growth</b>
<ul style="list-style-type: none"> <li>▪ Lower product prices than expected</li> </ul>	<ul style="list-style-type: none"> <li>▪ Sales price growth in line with forecasts</li> </ul>	<ul style="list-style-type: none"> <li>▪ Higher product price than expected</li> </ul>
<b>Costs:</b>	<b>Costs:</b>	<b>Costs:</b>
<ul style="list-style-type: none"> <li>▪ Higher COGS, export taxes, freight &amp; SG&amp;A as a percentage of sales</li> </ul>	<ul style="list-style-type: none"> <li>▪ COGS, export taxes, freight &amp; SG&amp;A as a percentage of sales in line with expectations</li> </ul>	<ul style="list-style-type: none"> <li>▪ Lower COGS, export taxes, freight &amp; SG&amp;A as a percentage of sales</li> </ul>
Price Target: \$1.96	Price Target: \$2.51	Price Target: \$2.99
Upside: 3%	Upside: 32%	Upside: 57%

### 3. Valuation

#### DCF – Gordon Growth



<u>PV of Operations</u>	<u>Method</u>	<u>Rate</u>
<i>WACC Calculation</i>		
WACC		11.39%
PV of FCFF		\$374,786,847
<u>DCF - Discounted Cash Flow</u>	<u>Method</u>	<u>Rate</u>
<i>Gordon Growth</i>		
PV Terminal Value		\$727,440,134
Add: TLCF		\$49,800,000
Add: Equity Investments		\$5,000,000
Enterprise Value		\$1,157,026,980
Less: Operating Leases		(\$9,000,000)
Less: Environmental accruals		(\$1,500,000)
Less: Employee future benefits obligations		(\$30,900,000)
Less: Discontinued Operations		(\$4,800,000)
Less: Silviculture Provision		(\$29,700,000)
Less: Debt		(\$79,700,000)
Add: Cash		\$1,800,000
Equity Value		\$1,003,226,980
Diluted Shares Outstanding		396,892,000
<b>Price Target</b>		<b>\$2.53</b>
<i>Current as Premium (Discount)</i>		33.04%

Source: DCM - WEF Financial Model VF

### 3. Valuation

#### DCF Output – Terminal EBITDA Multiple



<u>PV of Operations</u>	<u>Method</u>	<u>Rate</u>
<i>WACC Calculation</i>		
WACC		11.39%
PV of FCFF		\$374,786,847
<u>DCF - Discounted Cash Flow</u>	<u>Method</u>	<u>Rate</u>
<i>Terminal EBITDA Multiple</i>		4.5x
PV Terminal Value		\$775,489,430
Add: TLCF		\$49,800,000
Add: Equity Investments		\$5,000,000
Enterprise Value		\$1,205,076,276
Less: Operating Leases		(\$9,000,000)
Less: Environmental accruals		(\$1,500,000)
Less: Employee future benefits obligations		(\$30,900,000)
Less: Discontinued Operations		(\$4,800,000)
Less: Silviculture Provision		(\$29,700,000)
Less: Debt		(\$79,700,000)
Add: Cash		\$1,800,000
Equity Value		\$1,051,276,276
Diluted Shares Outstanding		396,892,000
<b>Price Target</b>		<b>\$2.65</b>
<i>Current as Premium (Discount)</i>		39.41%

Source: DCM - WEF Financial Model VF

### 3. Valuation

#### Comparable 2015 EBITDA Multiple



<u>PV of Operations</u>	<u>Method</u>	<u>Rate</u>
<i>WACC Calculation</i>		
WACC		11.39%
PV of FCFF		\$374,786,847
<u>Comparable Multiple</u>	<u>Method</u>	<u>Rate</u>
<i>2015 EBITDA Multiple</i>		
PV Terminal Value		\$979,022,410
Add: TLCF		\$49,800,000
Add: Equity Investments		\$5,000,000
Enterprise Value		\$1,033,822,410
Less: Operating Leases		(\$9,000,000)
Less: Environmental accruals		(\$1,500,000)
Less: Employee future benefits obligations		(\$30,900,000)
Less: Discontinued Operations		(\$4,800,000)
Less: Silviculture Provision		(\$29,700,000)
Less: Debt		(\$79,700,000)
Add: Cash		\$1,800,000
Equity Value		\$880,022,410
Diluted Shares Outstanding		396,892,000
<b>Price Target</b>		<b>\$2.22</b>
<i>Current as Premium (Discount)</i>		16.70%

Source: DCM - WEF Financial Model VF

### 3. Valuation

#### WACC Calculation



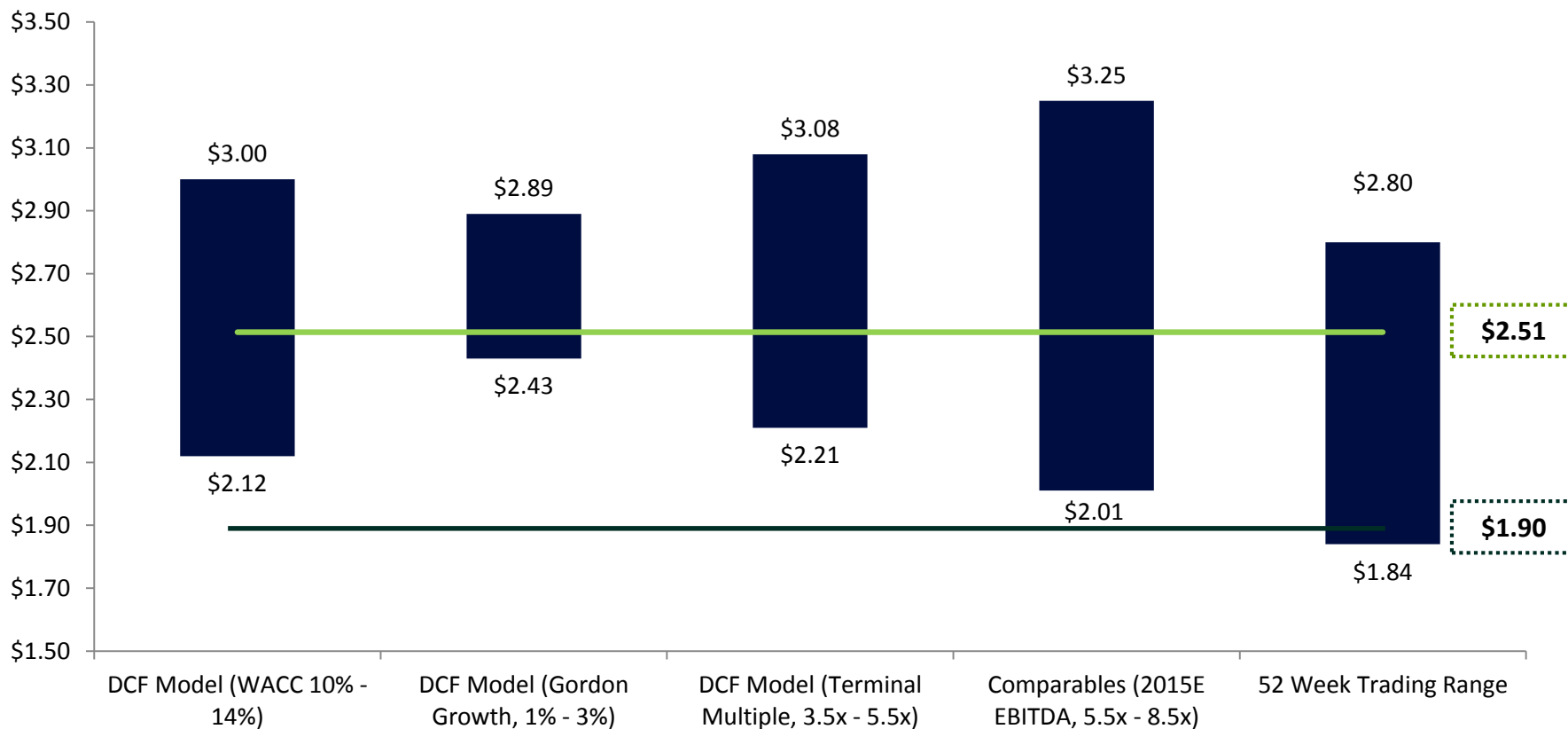
#### COMPANIES

WEF		CFP		IFP	
Market Value of Equity	1066.0	Market Value of Equity	4012.6	Market Value of Equity	1464.7
Market Value of Debt	79.7	Market Value of Debt	296.6	Market Value of Debt	220.4
<b>Enterprise Value</b>	<b>1145.7</b>	<b>Enterprise Value</b>	<b>4309.2</b>	<b>Enterprise Value</b>	<b>1685.1</b>
Debt-to-Equity	7.48%	Debt-to-Equity	7.39%	Debt-to-Equity	15.05%
Debt-to-EV	6.96%	Debt-to-EV	6.88%	Debt-to-EV	13.08%
Equity-to-EV	93.04%	Equity-to-EV	93.12%	Equity-to-EV	86.92%
<b>Cost of Debt</b>	<b>1.90%</b>	<b>Cost of Debt</b>	<b>1.30%</b>	<b>Cost of Debt</b>	<b>2.00%</b>
<b>Cost of Equity</b>	<b>12.14%</b>	<b>Cost of Equity</b>	<b>12.13%</b>	<b>Cost of Equity</b>	<b>12.71%</b>
Industry related risk premium	0.00%	Industry related risk premium	0.00%	Industry related risk premium	0.00%
Country Risk Premium (MRP)	9.00%	Country Risk Premium (MRP)	9.00%	Country Risk Premium (MRP)	9.00%
Risk Free Rate	1.48%	Risk Free Rate	1.48%	Risk Free Rate	1.48%
Tax Rate	25.00%	Tax Rate	25.00%	Tax Rate	25.00%
Levered ( raw regression) Beta	2.196	Levered ( raw regression) Beta	0.441	Levered ( raw regression) Beta	0.964
Unlevered Beta	2.079	Unlevered Beta	0.418	Unlevered Beta	0.866
<b>Relevered Beta</b>	<b>1.184</b>		<b>1.183</b>		<b>1.248</b>
<b>WACC</b>	<b>11.39%</b>	<b>WACC</b>	<b>11.36%</b>	<b>WACC</b>	<b>11.24%</b>
CANADA		Attributable Weights			
Risk Free Rate	1.48%	Gordon Growth	40.0%		
Industry Average		Terminal EBITDA Multiple	40.0%		
Unlevered Beta	1.121	2015 EBITDA Multiple	20.0%		
<b>AVERAGE PRICE TARGET</b>				<b>\$2.51</b>	

Source: DCM - WEF Financial Model VF  
Source Bloomberg Data March 19, 2015

### 3. Western Forest Products

#### Football Field



Price target of \$2.51 represents an upside of 32%

Source: DCM - WEF Financial Model VF

### 3. Valuation

#### Sensitivity Analysis



**Sensitivity Tables**

Growth	WACC					
		9.39%	10.39%	11.39%	12.39%	13.39%
	0.50%	\$2.81	\$2.63	\$2.48	\$2.36	\$2.24
	1.00%	\$2.88	\$2.68	\$2.52	\$2.40	\$2.27
	1.50%	\$2.96	\$2.74	\$2.51	\$2.44	\$2.30
	2.00%	\$3.05	\$2.81	\$2.62	\$2.48	\$2.34
	2.50%	\$3.16	\$2.89	\$2.68	\$2.53	\$2.37

Scenario	WACC					
		9.39%	10.39%	11.39%	12.39%	13.39%
	Bear	\$2.29	\$2.12	\$1.98	\$1.87	\$1.77
	Base	\$2.96	\$2.74	\$2.51	\$2.44	\$2.30
	Bull	\$3.50	\$3.25	\$3.05	\$2.88	\$2.74

After conduction the sensitivity analysis, we come to realize that WEF is trading at a discount in most cases

Source: DCM - WEF Financial Model VF

# Western Forest Products

## Bottom Line Analysis & Shareholder Return



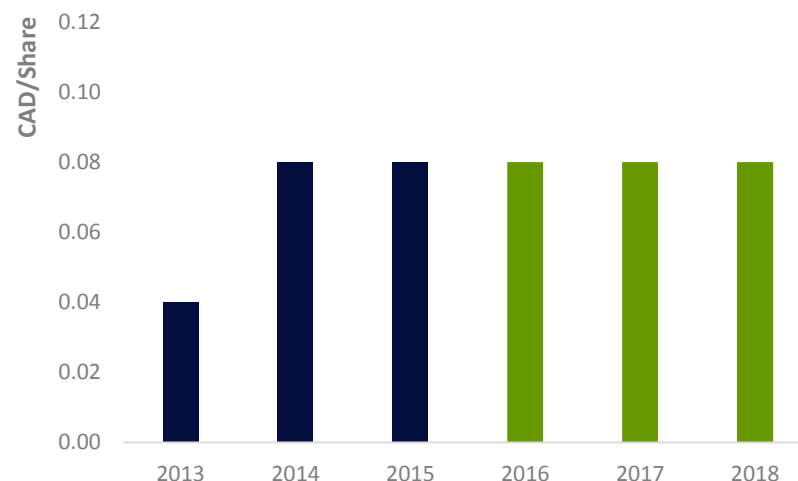
### Net Income & Diluted EPS



#### 2014 Highlights:

- Fluctuation in net income is mainly driven by adjusted EBITDA, effect of TLCF (2015-16) and other one time items such as \$8.1M in operating restructuring items
- Cyclicality in pricing and demand remains a significant driver of WEF's profitability.

### \$0.08/Share Dividend Program



#### Implementation of Quarterly Dividend Program:

- Management has taken steps to return value to shareholders
- \$100.3M in share buybacks in 2013 showing management's belief of undervaluation
- Positive sign of the company's long term outlook for future earnings and cash flows

Management has been taking steps to return value to shareholders by implementing a dividend program, repurchasing \$100.3M of shares in 2013. Also, the company has been paying down debt with proceeds from sales of non-core assets

Source: 2014 Annual Report & DCM forecasts

## Section VI

---

# Recommendation

# Western Forest Products

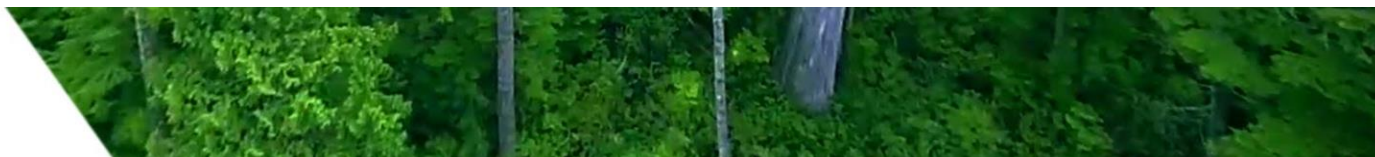
## BUY Recommendation With Price Target of C\$2.51

### Risks

- Changes in lumber/log demand and prices leading to a decrease in forecasted top line growth
- Stronger CAD against the USD
- Higher input costs and potential supply restriction from the Canadian government
- Further dispute with unionized labor force leading to unexpected wage increase
- Mountain Pine Beetle infestation affecting WEF's timberlands

### Catalysts

- Favorable lumber/log demand and prices to fuel WEF revenues
- Further recovery of the U.S. housing driving increasing demand for Canadian wood products
- Continued strength of the USD relative to the CAD
- Continued success in the implementation of the company's strategic capital investment program & realization of margin improvement expected in 2015-2016
- Capitalization on current opportunities to capture greater market share in the North American and Asian markets
- Value realization on potential sales of non-core assets & ability to reinvest in core assets



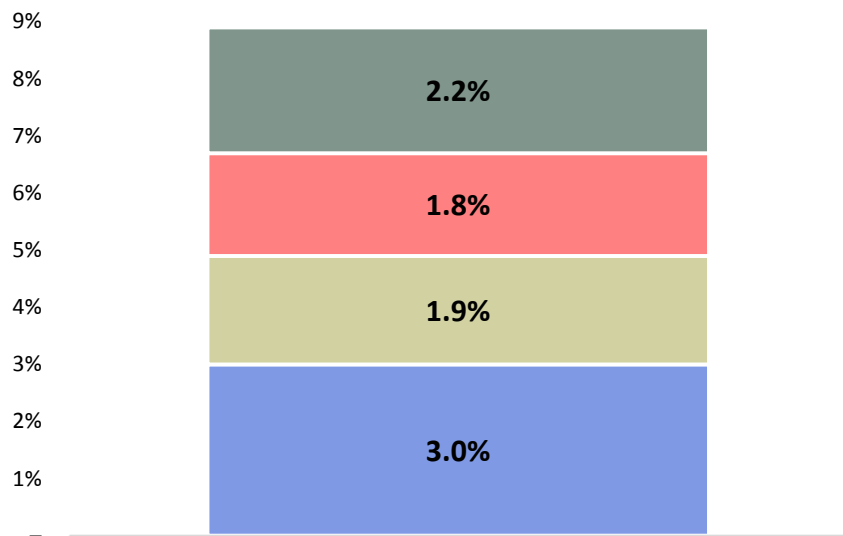
Strong forestry company with clear strategy for margin improvement and misunderstood business model

Stands to be a prime beneficiary of the recovery of the U.S. housing market

# Forward Looking Sector Allocation

## Further Diversifying Materials Portfolio

### Suggested Sector Allocation



**WEF** : Intermediate hardwood producer

+

**LUN** : Intermediate base metals developer/producer

+

**MUX** : Junior precious metals developer/producer

+

**MWV** : Paper & packaging major producer

=

**Well Diversified Materials  
Portfolio**

WEF's strong balance sheet, margin focused strategy, diversified revenue structure & attractive valuation reaffirm conviction buy

## Section VI

---

# Appendix

## Appendix I

---

# Forestry 101

# Forestry 101

## Wood Processing Primer:



### Forestry & Logging Companies (20%):

- Engage in field operations and harvesting of timber, including felling and hauling it to the mill



### Solid Wood Product Manufacturing Companies (44%):

- Engage in both primary (such as softwood lumber and structural panels) and secondary (such as millwork and engineered wood products) manufacturing



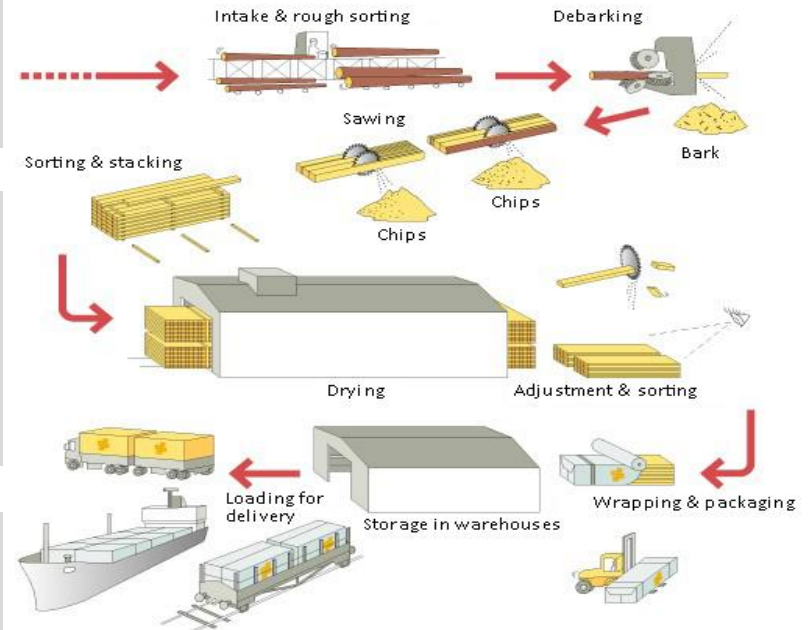
### Storage and Shipping Companies:

- Company that specialize in shipping and storage of wood products



### Pulp and Paper Product Manufacturing (36%):

- Production of a wide range of products, covering everything from newsprint and household tissues to dissolving pulp

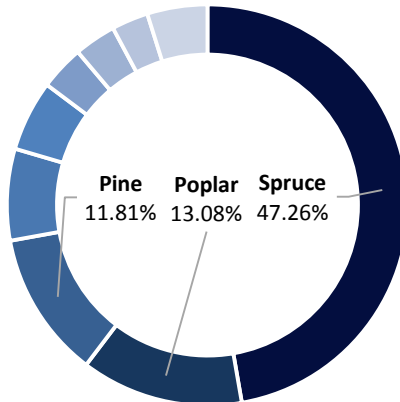


### Useful Metrics

<b>MBF</b>	One Thousand Board Feet
<b>MSF</b>	One Thousand Square Feet
<b>FBM</b>	One Board-Foot
<b>MFBM</b>	One Thousand Board Feet
<b>MMFBM</b>	One Million Board Feet

# Forestry 101

## Canada's % of Total Wood Volume by Species



## Softwood and Hardwood Classification

### Softwood:

- The wood from a conifer as distinguished from that of broadleaved trees (Pine & Spruce)

### Hardwood:

- The wood from a broadleaved tree as distinguished from that of a conifer (Poplar)

Source: Statistics Canada

## Canada's Main Solid Wood Products

- **Softwood Lumber:** Timber from softwood type trees sawed into rough planks or otherwise partly prepared (structural wood, 2x4 lumber planks, etc.)
- **Structural Wood Panels:** Wall covering panels constructed from wood and with rigid or semi-rigid components
- **Logs:** Sawed tree trunk in its rawest form
- **Engineered Products:** Versatile alternative to solid hardwood made of several wood layers (OSB, MDF)

## Geographical Consumption



## Appendix II

---

# Canadian Housing Market

# Canadian Forest Industry Outlook

## Canadian Key Exports By Product Type

### ▪ Northern Bleached Softwood Kraft Pulp (NBSK)

- Canada supplies 1/3 of global production and 3/4 of the North American production and holds the largest share of the global NBSK market
- NBSK is an increasingly important pulp grade for paper and tissue production
- The value of the Canadian dollar has a major impact on performance, given the global nature of this market

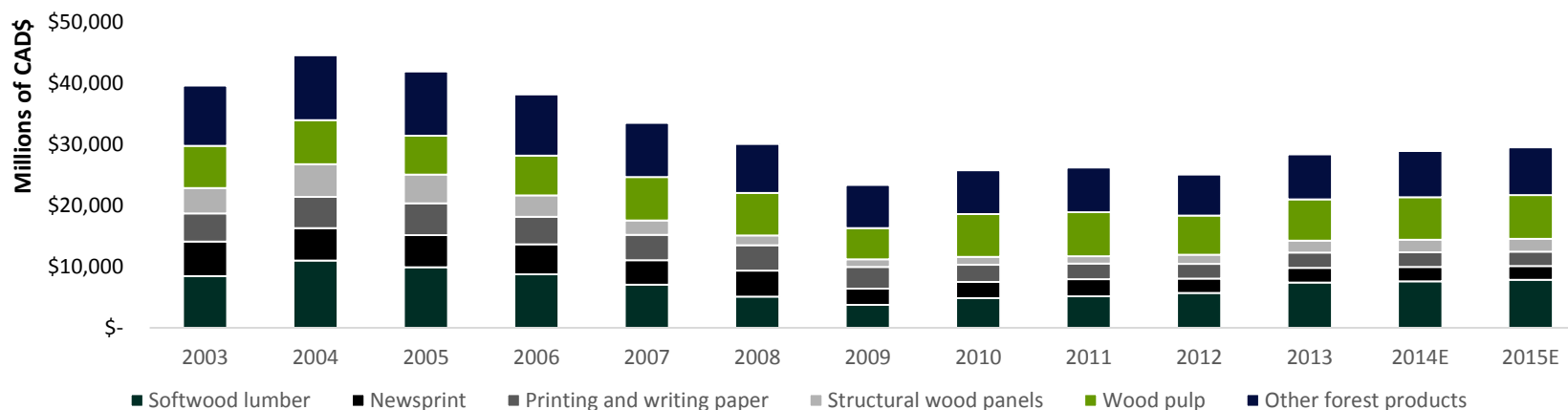
### ▪ Newsprint

- Canada is the single largest producer of newsprint products with 21% market share
- Demand for newsprint in North America has fallen by 65% since 2000 as a result of structural changes in the marketplace

### ▪ Softwood Lumber

- Canada is one of the largest producer globally
- Mainly used in the construction of houses

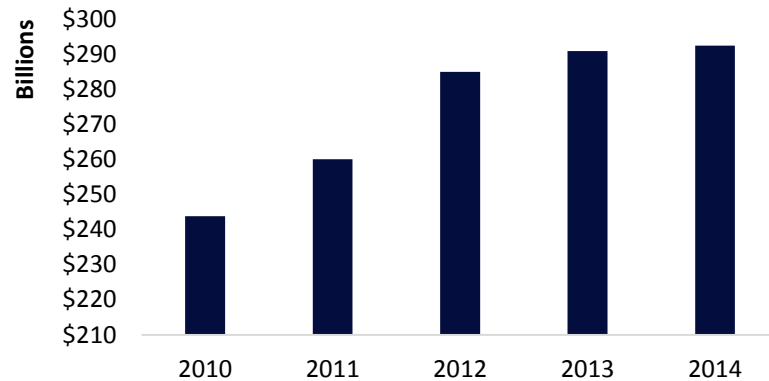
## Exports of Canadian Forest Products (2003-2015E)



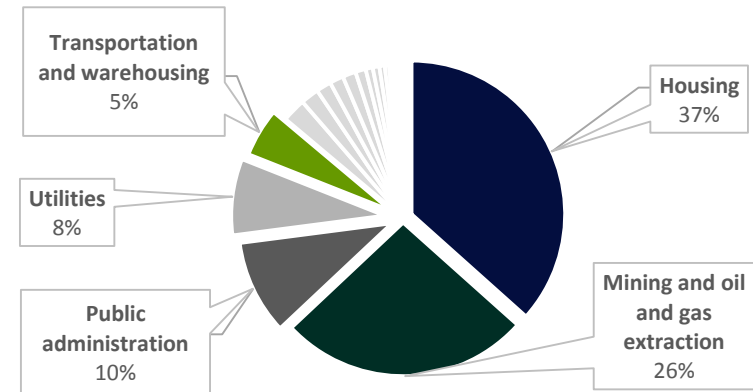
Source: Statistics Canada – Merchandise Trade Balance Data

# Canadian Forest Industry Outlook

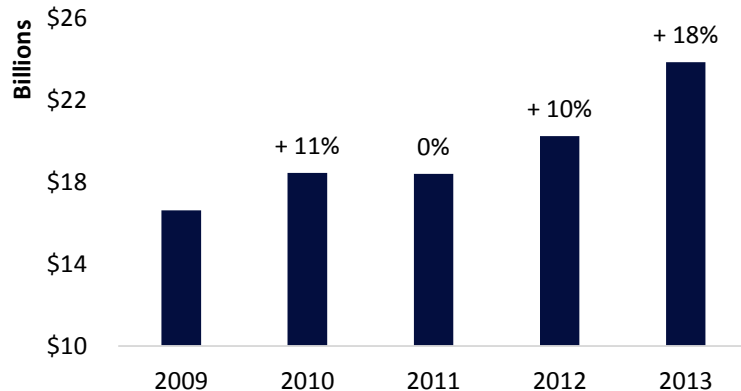
## Canadian Construction Capital Expenditures



## 2014 Capex For Construction by Sectors



## Canadian Wood Products Manufacturing Sales



## Promising Industry Fundamentals

- The total construction capex has proved to grow steadily in the past 5 years
  - Despite signs of a recovery, the recent collapse in commodity prices might negatively impact the amount of capex from mining and oil companies, which represent 26% of the Canadian total capex for construction purposes
- The total value of wood products manufacturing sales in Canada has gained more than 40% since 2009 levels

Source: Statistics Canada.

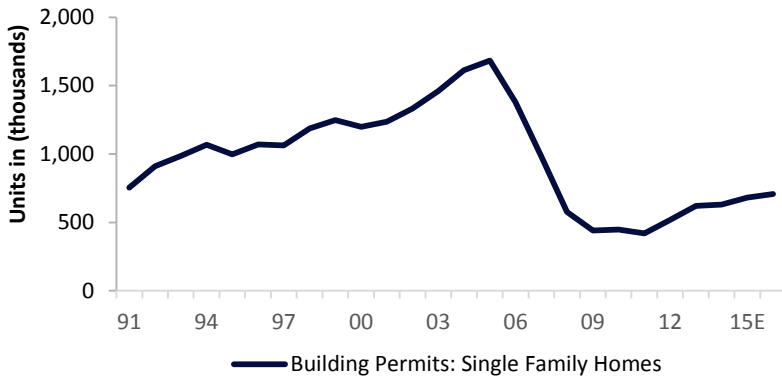
## Appendix III

---

# United-States Housing Market

# United States - Housing Market Outlook

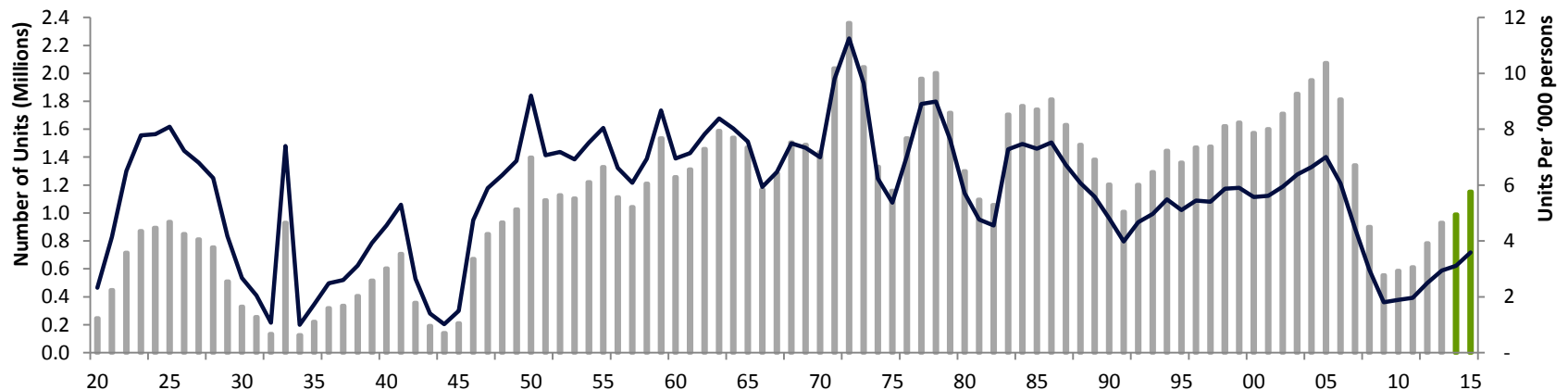
## Single Family Home Building Permits



## Housing Starts Below Underlying Demand



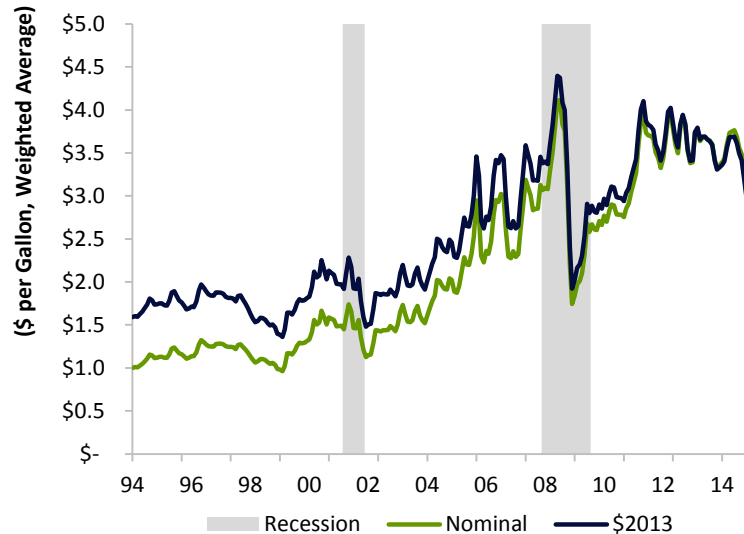
## Housing Starts Near Depression Levels (1925-2015E)



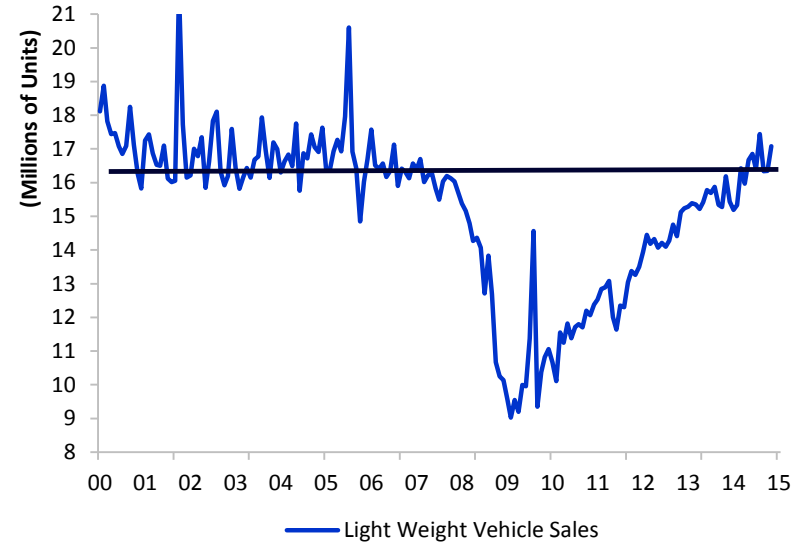
Source: (FEA) Forest Economic Investor Presentation

# United States - Housing Market Outlook

## Lower Gasoline Prices Boost Purchasing Power



## Vehicle Sales Are Back to Pre-Recession Levels



- Lower gasoline prices across the U.S. will most likely increase the purchasing power of U.S. household
- This will positively impact the residential & business construction and remodeling investment
- U.S. vehicles sales have finally returned to prerecession levels in the end of summer 2014 after an extended slump at below normal levels
- Residential properties sales isn't too far behind and is forecasted to pick up following the increase in vehicle sales as people benefit from stronger household balance sheet.

Source: (FEA) Forest Economic Advisor Presentation  
(1) All Grades, All Formulations of Gasoline

## Other Financial

---

- We expect renewed growth in earnings to take hold over the next two years
- Western has several attributes that we consider as differentiating factors:
  - a unique B.C. Coastal lumber grade profile (diverse grade/end-market mix)
- Flexible log procurement and sales program with a dominant regional position
- benefits associated with the company's discretionary capex/non-capital margin improvement programs.
- We believe that Western trades at an excessive valuation discount, especially in light of the potential sales of noncore assets and its flexible balance sheet

---

Source: (FEA) Forest Economic Advisor Presentation  
(1) All Grades, All Formulations of Gasoline

## FY 2014 MD&A Key Takeaways

---

### Higher Revenues 2014 vs 2013:

- 6% growth
- Increased sales volumes and positives lumber sales mix
- Strong domestic log market
- Benefit of stronger USD and weaker Canadian dollar

### Lumber production:

- Timberlands harvesting decreased 5% in 2014 due to dry-weather conditions in 3Q 2014.
- Were able to offset lower production by buying logs and standing timber in the open market. This is a reason why margins were down.
- Overall lumber production was up 3%, highest production ever, allowed the company to meet strong demand for WRC, western red cedar lumber products

### Reduction in EBITDA and EBITDA margin:

- Lower pricing in China and Japan market due to weaker market conditions, increased labor costs as a result of new labor agreement, reduced log availability, increased log price, higher stumpage, and harvesting in higher cost timberlands operations also contributed to the year-over-year reduction in adjusted EBITDA.

---

Source: (FEA) Forest Economic Advisor Presentation  
(1) All Grades, All Formulations of Gasoline

## United States - Housing Market Outlook

---

Offsetting factors which led to 2014 record revenue:

- Strong demand for WRC products and the company's flexible manufacturing platform, which allowed us to shift production from Japan lumber programs to Niche programs.
- Weaker CAD which was 7% lower during 2014.
- Higher lumber commodity price

Lower Net Income:

- 68.4 Million in 2014 vs. 2013 125.4 Million, due to; deferred income tax recovery of 26Millions in 2013, lower adjusted EBITDA in 2014 and an incremental 10.1 Millions in restructuring charges in 2014.

Quarterly Dividend program in 2014:

- Regular cash dividends of \$0.02 per shares totaling 31.4 Million in dividend was distributed to shareholders in 2014.

Increased liquidity:

- Decreased effective interest rate and extended the term to maturity through to June 2019 by amending its revolving term loan facility. The company liquidity position as December 31, 2014 has improved to 134.4 M compared 125.9M. The increase in the liquidity has mainly came from cash generated by operations.
- The company just sold one of its old pulp mill site which was considered non-core from its business model and focus for 21.8 Million.
- The money will be used to repay its term loan and the lower interest revolving term loan facility will be used to finance future capital investment

---

Source: (FEA) Forest Economic Advisor Presentation  
(1) All Grades, All Formulations of Gasoline

## Investment Thesis

- We expect renewed growth in earnings to take hold over the next two years
- Western has several attributes that we consider as differentiating factors:
  - 1) a unique B.C. Coastal lumber grade profile (diverse grade/end-market mix)
  - 2) Flexible log procurement and sales program with a dominant regional position
  - 3) benefits associated with the company's discretionary capex/non-capital margin improvement programs.
  - 4) We believe that Western trades at an excessive valuation discount, especially in light of the potential sales of noncore assets and its flexible balance sheet

# Canadian Forest Industry Outlook

---

## Key Destinations of Canadian Forest Products

---

### ***Canada***

- Recent recession has affected demand for solid wood products
- Housing and general construction market expected to remain an important source of demand for Canada's Forest sector
- Devalued CAD\$ and low interest rates likely to drive foreign investment within Canada
- Attractiveness of borrowing to either built new homes or take on improvement and remodeling projects

### Main threats:

- Large percentage of demand coming from extraction industries
- High level of debt of Canadian households

### ***United States***

- Remain the most important market for Canada's forest sector
- The Recovering housing market will drive demand

---

Source: Statistics Canada

# Canadian Forest Industry Outlook

---

## Key Destinations of Canadian Forest Products

---

### *China*

- Lumber exports grew remarkably in recent years and are beginning to expand beyond low grade lumber to higher value products
- Canada's Forest Products Association has partnered with the Canada Wood Export Program to develop Chinese demand for higher grade lumber and so far, has proven to be successful
- **Management's view:** Continued growth in China's lumber consumption will sustain demand for western products in the short term and is expected to rebound as inventories decline.

### *Japan*

- Important market for Canada's high value wood products and structural lumber for use in housing
- Growing Japanese demand helped the Canadian forest industry to offset lower demand from the U.S. in the 2008-09 housing crisis
- Since then, has weakened as a result of stagnant population growth and economy
- **Management's view:** The Japan housing market has stabilized which should support improved demand and pricing in the spring of 2015

---

Source: Statistics Canada