

**Western Forest Products Inc.
(WEF: \$0.195)
Sell Rights****Outperform
Target Price \$0.40**
(reduced from *pro forma*
adjusted \$1.10)

Western Forest Products ("Western") is conducting a rights offering whereby each owner of an existing common or non-voting share has the right to acquire 1.28737 new common shares at a price of \$0.19 each. The offer expires at 4.00 PM Toronto time on Tuesday, January 20, 2009. Those not wishing to exercise their rights may sell them. The rights have been trading at or below \$0.005. Tricap, an affiliate of Brookfield Asset Management ("Brookfield") and the owner of 49% of Western's common stock and 70% of its total common and non-voting stock, has agreed to buy all common shares not otherwise purchased pursuant to the rights offering.

We do not recommend exercise of one's rights. We are maintaining our Outperform rating on the shares but lowering our price target from \$2.20 to \$0.40. The \$2.20 previous target is approximately \$1.10 adjusted *pro forma* for the rights offering.

January 13, 2009

We have three reasons for recommending that rights not be exercised:

Reasons for Recommendation

First, although non-exercise will entail a dilution of one's net asset value, the price-to-book ratio is already very low. The present share price of \$0.195 and the exercise price of \$0.19 compare with per-share net asset value of \$1.60 before the offering and a *pro forma* value of \$0.80 after it. Even those values understate realizable asset value, because Western Forest Products last year announced a \$150-180 million sales program of non-core assets that we believe are carried below realizable value. When the discount from realizable asset value is so great, it is more constructive to hope for a rise in share price than to spend good money to maintain one's proportionate share of net assets.

Second, the \$49.6 million net proceeds of the offering will be used to pay down the revolving line of credit. Since the revolving line originated with Western's dominant shareholder Brookfield and was then assumed by an associate company, probably with Brookfield's guarantee, the new money subscribed will flow indirectly to Brookfield. Shareholders are put on notice, moreover, that the "amounts repaid under this facility will be available to be redrawn for general corporate purposes." There is no reason why this circular process should be expected to end, and no reason to believe that shareholders' injecting new money through the revolving door should increase their realizable net asset value.

Third, we presume that at some point Brookfield will want to take Western Forest Products private. Rights offerings are a way of taking out the minority without having to make a formal bid. If an owner exercises his rights, his money flows indirectly to Brookfield, and the day of his departure is postponed. If he does not exercise, his proportionate interest in net assets is reduced – and so effectively that interest becomes Brookfield’s without a bid’s having to be made. It is difficult to see how Brookfield can lose from such offerings, and difficult to see how a minority shareholder in Western can win.

Quantitative Breakdown, Western’s Share Ownership

The attached Table 1 conveys our understanding of Western’s share ownership breakdown – first as it is today; then as it will be if all shareowners exercise their rights; and finally as it will be if the small number of minority shareholders – representing only 18.5% of the currently outstanding common shares – choose not to exercise their rights. Our numbers are based on disclosures in the prospectus. We believe Table 1 is correct for working purposes, but we do not guarantee its complete accuracy in all respects.

As is clear from Table 1, the true unaligned public shareholders have no power at all to influence this company. It makes no difference whether they exercise their rights and own 18.5% of the common stock, or do not exercise and have only 10.1%. The Table exposes two myths that have been allowed to take root with respect to Western. One is that the Harbinger group is independent of the controlling shareholder Brookfield, even though the two entities have acted cooperatively at least since the Doman Industries restructuring got under way in 2002. The other is that Brookfield does not literally control Western Forest Products because its affiliate Tricap holds only 49% of the voting common. That latter myth is becoming increasingly untenable, as rights offerings are made to take money from the minority owners and more and more stock must be acquired by standby purchasers on behalf of Brookfield and stored on the non-voting shelf. According to Table 1, if the minority take our advice and do not exercise, non-voting shares will grow from 41% to 53% of the total common and non-voting shares. Yet we are asked to believe that the non-voting shares are not relevant to control of Western, and that the ability to convert them at any time into voting common is an attribute that belongs to Western rather than to Brookfield.

Governance issues have punctuated Brookfield’s assumption of its present powerful role in British Columbia’s forest industry. Although Brookfield’s split-share structure allows a small coterie of managers and directors to control the entire company, the Ontario and BC Securities Commissions have allowed it free rein to raise equity capital in the markets as if it were a thoroughly public company. The restructuring of Doman into Western under BC court supervision had many controversial features. It appears that creditors were allowed to buy and sell positions in the course of the proceedings, that creditors were able to convert positions at par even if they had paid less than par, and that practically no effort was made to evaluate, and realize the value of, Doman’s most important assets (including the supposed private lands within tree farm licences that are now such a contentious issue). Finally, the BC Minister of Forests failed to consider retracting forest tenures after the extra-provincial property company Brookfield had gained effective control of Western. The minority owners of Western – and, indeed, the public generally – have reason to believe they have been let down by their securities regulators, their judicial system, and their elected officials.

Under conditions such as these, it is exceedingly unlikely that the minority shareholders will ever realize more than a fraction of their shares' fair value. We reiterate our recommendation that they should not exercise their rights – to exercise would only be to put good money after bad. We have considered expressing our dissatisfaction by recommending the outright sale of positions, but the share price is abusively low, and to sell at these levels would only help the dominant shareholder take the company private without a bid. In the hope that the price might see some recovery after the rights offering is behind us, we are recommending sale at a price of \$0.40 or better – just half the September 30, 2008 net asset value per share adjusted *pro forma* for the rights offering.

**Table 1. Western Forest Products' Share Structure
Before and After Rights Offering**

	Total Shares (million)	Of which: Common (million)	Of which: Nonvoting (million)
At present	204.4	119.8	84.6
Of which:			
Owned by Tricap / Brookfield	143.3	58.7*	84.6
Owned by Harbinger	38.9	38.9	
	182.2	97.6	
Owned by Public	22.2	22.2	
After offering (if public exercises)	467.6	274.1	193.5
Of which:			
Owned by Tricap / Brookfield	327.8	134.3*	193.5
Owned by Harbinger	89.1	89.1	
	416.9	223.4	
Owned by Public	50.7	50.7	
After offering (if public does not exercise)	467.6	218.8	248.8
Of which:			
Owned by Tricap / Brookfield	356.3	107.5*	248.8
Owned by Harbinger	89.1	89.1	
	445.4	196.6	
Owned by Public	22.2	22.2	
* 49% of Common Shares outstanding			

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